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S. Hrg. 104–646

S. 94, PROHIBITION ON THE CONSIDERATION OF RETROACTIVE TAX INCREASES

Y 4. G 74/9: S. HRG. 104-646

S. 94, Prohibition on the Considera...

HEARINGS

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

ON

S. 94

TO AMEND THE CONGRESSIONAL BUDGET ACT OF 1974 TO PROHIBIT THE CONSIDERATION OF RETROACTIVE TAX INCREASES

DECEMBER 7, 1995

Printed for the use of the Committee on Governmental Affairs

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S. 94, PROHIBITION ON THE CONSIDERATION OF RETROACTIVE TAX INCREASES

THURSDAY, DECEMBER 7, 1995

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:38 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Ted Stevens, Chairman of the Committee, presiding.

Present: Senators Stevens and McCain.

OPENING STATEMENT OF CHAIRMAN STEVENS

Chairman STEVENS. Let us get started if we may.

Today, we are going to hear from Senator Coverdell and Senator Hutchison and others who are here to discuss S. 94. S. 94 would prohibit Congress from considering legislation that applies tax increases retroactively.

Under S. 94, it would be out of order for either House of Congress to consider any bill, joint resolution, amendment, motion or conference report that increases a tax and applies the increase to a taxable year beginning prior to the enactment date of the law.

The tax increases targeted by S. 94 include a change in any tax rate, deduction, exemption, credit, exclusion, or similar change to the Internal Revenue Code of 1986, which would result in an obligation to pay a larger tax.

This prohibition could be waived or suspended in the Senate only by an affirmative vote of three-fifths of its Members. An affirmative vote of three-fifths of the Senate would also be required to sustain an appeal of the Chair's ruling on a point of order raised under the law.

In effect, this is an amendment to the Budget Act.

Today, the witnesses will assess the fairness, economic impact and constitutionality of retroactive taxation. People in my home State of Alaska are very much opposed to retroactive taxation. Alaska and our people rely on seasonal industries, harvests and employment cycles. This type of economy demands certainty and fairness in tax policy.

We are here to evaluate whether S. 94 addresses the concerns of vulnerable taxpayers such as ours, as well as the needs of United States companies that underpin our national economy.

We are pleased to have with us today the sponsors, and before I call on Senator Coverdell, I will ask Senator Glenn for any opening comments he may have.

OPENING STATEMENT OF SENATOR GLENN

Senator GLENN. Just very briefly, in principle, I am very much for this. I do not like things that go back, when people have done their economic planning and their financial planning, and then, all of a sudden, they get hit with something later that they did not anticipate. That is not fair. It is not fair in tax law any more than it is fair in other law.

I am certainly willing to hear the case here. I question whether there may have been a time when we have passed a tax law, and it is in effect, then we find out there is some inequity, and we go back and alter something, perhaps to pick up people who were inadvertently left out or something like that. I would hate to see that type of situation completely eliminated from consideration by law. But that would be a unique situation, I think, and I am certainly happy to hear the testimony, and I understand it is the Chair's intention to go to markup on it next Tuesday, so we are going to be on a fast track. I certainly want to hear all sides of this.

Thank you much.

Chairman STEVENS. Thank you, Senator Glenn.

Senator McCain?

OPENING STATEMENT OF SENATOR McCAIN

Senator MCCAIN. Mr. Chairman, I want to thank our witnesses today, Senator Coverdell and Senator Hutchison, for their efforts on what I believe, as you just mentioned, not only in your State, but in mine and I think all over America, is what many Americans believe is a fundamental unfairness, and that is the practice that we have unfortunately adopted over the years in retroactive taxes.

Mr. Chairman, let me remind you that on August 6, 1993, the need for this legislation became abundantly clear. The President's budget plan was before the Senate, and passage appeared imminent. A close read of the President's plan revealed that taxes were being applied retroactively. Even people who had passed away were going to have to pay higher taxes—prompting, by the way, Jay Leno that night to say that, "Now we tax live people, and we tax dead people; does that mean we tax Al Gore twice?" I would never have said that myself; I would never have made that comment myself, Mr. Chairman. But at that time, I raised the constitutional point of order that the retroactive tax increase in the conference report which predated April 8, 1993—the day the President sent Congress his plan—were in violation of the Due Process Clause of the 5th Amendment to the Constitution.

As the Rules of the Senate dictate, as we all know, the point of order was decided by the full Senate, which unfortunately chose to ignore the Constitution on a party line vote.

I am pleased that we are now seeking to take politics out of this process. The Constitution and its provisions that protect individuals must never be subjugated to political concerns. I hope that this legislation will change the way we operate and prevent future generations from being burdened with any retroactive tax increases.

I look forward to hearing our witnesses.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR MCCAIN

Mr. Chairman, I want to thank you for holding this hearing today. Passage of this legislation which would make it more difficult to pass and implement retroactive taxes is long overdue.

On August 6, 1993, the need for this legislation became abundantly clear. The President's budget plan-was before the Senate and passage appeared imminent. A close read of the President's plan revealed that taxes were being applied retroactively. Even people who had passed away were going to have to pay higher taxes.

At that time, I raised a Constitutional Point of Order that the retroactive tax increases in the conference report which pre-dated April 8, 1993—the day the President sent Congress his plan—were in violation of the Due Process Clause of the 5th Amendment to the Constitution.

As the Rules of the Senate dictate, the point of order was decided by the full Senate which unfortunately chose to ignore the Constitution on a party line vote, every Democrat voted that the point of order was not well taken and therefore it fell.

I am pleased that we are now seeking to take politics out of this process. The Constitution and its provisions that protect individuals must never be subjugated to political concerns. I hope that this legislation will change the way we operate and prevent future generations from being burdened with any retroactive tax increases.

I look forward to hearing our witnesses.

Chairman STEVENS. Thank you very much.

Senator Coverdell?

TESTIMONY OF HON. PAUL COVERDELL, U.S. SENATOR FROM THE STATE OF GEORGIA

Senator COVERDELL. Thank you, Mr. Chairman.

I want to thank the Committee and the members who are here in attendance; my co-author, who is present to testify; and of course, all the witnesses who have taken from their schedules to visit about S. 94 and the concept that it represents.

I want to begin my testimony by quoting a gentleman of some substance in American history, Thomas Jefferson, who wrote: "Every man should be protected in his lawful acts and be certain that no *ex post facto* law shall punish or damage him for them."

The sentiment that *ex post facto* laws are against natural right is so strong in the United States that few, if any, of the State constitutions have failed to proscribe them. They are equally unjust in civil as in criminal cases, and the omission of a caution which would have been right does not justifying the doing of what is wrong.

I think Thomas Jefferson was eminently correct. Even the Russian Constitution, newly adopted, would not allow what occurred in August of 1993, or any of the other instances of retroactive taxation.

There is a pending constitutional amendment to prohibit it—but we all know the exercise that represents—that is before the Judiciary Committee. If that ever comes about, it will be a long time, and therefore we sought relief through legislation.

But I think a word or two about the Constitution is in order because in my belief, while it has been abrogated, the Constitution deals with retroactive taxation in three separate provisions. First, it deals with it in due process, as Senator McCain of Arizona has already alluded to. And it deals with it in *ex post facto* treatment. Case history ultimately said *ex post facto* could only apply in criminal and not civil matters. I just think that is an abrogation and a dilution of the original document passed by our Founding Fathers. And last, the provision in the Constitution that deal with bills of

attainder—i.e., legislation that seeks out a select class of people for special treatment or harm—under the Constitution, the Constitution prohibits that.

You need but look at the debate of the most recent retroactive taxation that occurred in August of 1993, and it is eminently clear that the legislation was directed at a certain class of Americans.

Mr. Chairman, I come from a small business background, and of course, the majority of American businesses are small. And the capacity to deal with a Congress that arbitrarily and capriciously changes the rules midstream is most, most difficult and very destabilizing to our families, our businesses and our communities.

And even beyond retroactive taxation, the changing of the rules midstream has become an all too frequent habit on the part of the legislative branch of the United States. It has already been alluded to, but if we put this question to the American people, 80 to 90 percent of them, on the foundation of common sense, would tell us that this practice is wrong, it is not honest, it is morally corrupt and should be stopped. They seem to know what we have had so much difficulty in understanding.

As we know from the last retroactive taxation, we even went beyond the current administration and reached back to another administration in the context of the reach of the retroactive taxation that occurred.

I have just finished a work on the Budget Act that dealt with farm programs, and one of the arguments I was making was that, with regard to how we modify these, we have to be very careful that in a context we do not retroactively change the rules and make it difficult for people to transition to programs or directions that we would like them to receive. But the idea of a taxpayer in America beginning the year with a set of conditions and rules and finding himself at the end of the year with all his plans being for naught because we decided we would change the rules back to January is incomprehensible to me. It is simply incomprehensible. And you could not find a handful of Americans who would find any rationale or logic behind that.

I want to respond specifically to your point, Senator Glenn. Obviously, if we were trying to discover a way to deal with a technical flaw, I think all of us, and most Americans, would come to the table and try to find language that would allow us the flexibility to deal with a mistake or something of that nature. But historically, both parties, a multitude of Presidents, the retroactive practices have not been on technical matters; they have been changing the rules after the fact, after the planning, and exceedingly destabilizing. And that practice should be stopped.

Mr. Chairman, I will conclude my testimony and turn to my coauthor, Senator Hutchison.

Senator Hutchison?

TESTIMONY OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM THE STATE OF TEXAS

Senator HUTCHISON. Thank you, Mr. Chairman.

I certainly appreciate your holding this hearing, and I hope that this bill can be marked up and sent to the Senate quickly, because

I think we have a sort of muddled precedent here, and I would like it to be clarified.

As has been mentioned on the Budget Reconciliation Act of 1993, there was a retroactive tax increase. Senator Burns and I tried to make the tax prospective and barely failed. It was a very close vote, but we did fail. Then, Senator McCain raised a constitutional point of order against the retroactive tax, and that also barely failed.

It was followed, then, by a Supreme Court case on an estate tax issue, where the Supreme Court further muddied the waters, saying that "Provided there is a retroactive application of a statute supported by a legitimate legislative purpose, furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches."

So I think that we need to step in and clarify this issue. I think it is most important that the legislative branch step up to the line and say that we are not going to countenance the retroactive taxation of individuals. And I think that a 60-vote requirement takes a great step in that direction, and that is what is provided for in this bill, which I am the cosponsor of.

So I very much appreciate your apparent support for this. I think it is something we must do to lay a good foundation for the future so people will not have to worry about a destabilizing tax for which they were not able to plan.

Thank you.

Chairman STEVENS. Thank you, Senator Hutchison.

I have just one question: Why now? Why do we need this now?

Senator COVERDELL. We should have done it sooner, is my answer; it is unfortunate that it has not occurred previously.

I think that, for whatever reason, the judicial branch has not been a friend of the concept, so whatever constitutional protections were there have been abrogated. As the Senator from Texas has just alluded, even in the latest case, which I found unfathomable, nevertheless it is the finding of the Supreme Court that we have the authority to tax retroactively, even though there are those who would argue constitutionally that it should not occur. But that has not prevailed, and as a result, we have a lineage of history, the most recent event being August of 1993, where an egregious retroactive taxation occurred.

And I hasten to say to my colleague from Ohio that this has occurred under Presidents of both parties. It has not been all that frequent, but it has been frequent enough that we should make clear to the American people that they are protected from this behavior because it is incorrect.

Chairman STEVENS. Well, they would be protected as long as 60 Senators did not vote to waive the rule.

Senator COVERDELL. But in much of our law, that is the extent of their protection.

Chairman STEVENS. Senator Hutchison?

Senator HUTCHISON. I would just say that I think it is important, too, that we look at a legislative precedent and a Constitution that says we will not take property without due compensation. And I think this is a taking of property by going in when someone is not

expecting it and when they have no recourse because it is retroactive. It is against every principle we hold, and it is against the Constitution, and I think we have allowed it to get fuzzy, and I think it is incumbent upon us to make it clear.

Chairman STEVENS. Senator Glenn?

Senator GLENN. Thank you, Mr. Chairman.

I truly came to the hearing this morning with an open mind; I really did. I thought we were going to examine the entire history of this thing and go back and really try to do something that I thought was right. Yet the only example I have heard mentioned so far is the 1993 Tax Act. The 1993——

Senator COVERDELL. Senator, I have alluded to multiple administrations——

Senator GLENN [continuing]. You mentioned that there have been other things in the past. But let me just point out a couple of things here so we can set the record straight.

Ronald Reagan is one of our most popular Presidents. There were retroactive tax increases in 1981, 1982, 1984, and 1986—and these were not little, tiny things, and they were not on just the top income people. These were big-time, retroactive tax increases, and they were nasty ones. I will put that word to it.

You talked about Clinton being egregious and so on. I am beginning to wonder this morning whether you are serious about this, or whether this is something being built up for the 1996 campaign, quite honestly.

I think it needs to be done across-the-board, and I think we ought to discuss it with regard to Republicans, Democrats, whomever, and not just keep pinpointing Clinton and 1993, which incidentally resulted in the first budget reductions from $300 billion at that time, to $246 billion, and about $192 billion or less right now. We are on the right track, whether the tax increase was retroactive or not, but that is a different subject to bring up here.

We are talking about Reagan—1981, 1982, 1984, 1986—and Senator Dole was chairman of the Finance Committee then, when the conference report came out on the Tax Equity and Fiscal Responsibility Act reported for consideration by Congress in August of 1982. Unemployment was up to 10 percent. The retroactive taxes contained in that 1982 conference report have been added—Senator Dole said this; "near the end of the conference," and had not even been part of the bill. The conference added those in conference and brought them back. And the 1982 bill retroactively taxed unemployment benefits at a time when unemployment was going up by retroactively lowering the taxation thresholds back to January 1st of 1982.

This provision which was enacted into law required 5.3 million Americans to pay 8 months of back taxes on previously exempt income. I thought that was terrible, and I still think it is terrible.

So if we are getting around to giving examples here, let us give some examples that are bipartisan. I use that example because I do not want the 1993 tax increase on the top one percent of taxpayers to be our only example of a retroactive tax and why we need something like this.

I came to the hearing this morning thinking we were going to look across the board on this thing. I might add, too, that President

Clinton said on February 17th, 1993 that he would seek this sort of a tax increase for the year, so people were sort of forewarned, although it was not law. Let us go back and give the whole record. If we are going to look at this legislation and mark it up next Tuesday, let us do it fairly and because it is needed for Democrats and Republicans and anybody else who ever may be President of the United States.

I sit here and hear this "egregious" Clinton and 1993 Clinton, and 1993 Clinton, and 1993 Clinton, as the reason why we need this thing. I think we need it more because of what Republican Presidents have done than we do because of Bill Clinton. So let us just set the record straight on that one.

Senator COVERDELL. Do you mind if I respond? First of all, let me say that I did allude to the fact that it was multiple administrations and Presidents of both parties.

Senator GLENN. You made a passing reference to it, yes.

Senator COVERDELL. And I would be more than glad to list them all. It has occurred, however, I would say, under 12 Democrat Presidents and one Republican. That is the record. But we can put it into the record.

I was only here in 1993——

Senator GLENN. Well, you knew what was going on in 1993.

Senator COVERDELL [continuing]. So this is the one that has brought this issue to my attention. Having said that, I think each of them was incorrect. The ones you alluded to were incorrect; I do not think those are right. This, however, is the first rate increase that ever occurred and the first that occurred beyond the administration.

Senator GLENN. If I understood the Chairman correctly, Senator—and I do not want to belabor this thing because we want to get on with other testimony, of course—but "Why now?" is what the Chairman asked. And I believe it came back, that well, the most recent example was 1993 and so on, or at least that had been alluded to before, and that is apparently the reason why we are doing this right now.

I think if we are building up a campaign point for 1996, OK, let's just say we are building up a campaign point to lambast Clinton in 1996. But let us go back and lambast a few Republicans while we are doing that, if we are going to pass this kind of legislation. That is what I say.

Chairman STEVENS. Well, Senator, I had hoped the answer would be that we are going into a balanced budget period, and there will be a real, real test of the Presidency not to suggest retroactive tax increases if we fail to meet goals in this 7-year period. I think this is needed now to be an absolute warning to everybody that the Senate intends to have a rule that prevents tax increases in this very difficult period of the next 7 years.

Senator COVERDELL. Whoever is President.

Chairman STEVENS. I should have made the statement rather than asked the question.

Senator HUTCHISON. Mr. Chairman, could I also——

Senator MCCAIN. Mr. Chairman, may I chime in on this nonpartisan discussion?

Chairman STEVENS. Well, Senator Hutchison wants to answer.

Senator MCCAIN. I am sorry. Go ahead. I will wait.

Senator HUTCHISON. I would just like to answer by also saying that the Supreme Court I think has really added to the muddiness on this issue, and this was a case decided in June of 1994. I think if the Senator from Ohio believes that this is in any way partisan that it would be great to have a unanimous vote out of this Committee so that it is bipartisan, because it is wrong, it is fundamentally wrong, to do this. And I think for the entire U.S. Senate to unanimously approve this and exercise the very important responsibility that we have, which is to provide our part of the balance of powers. When the Supreme Court has an interpretation with which we disagree, and it is a legislative matter, we need to fulfill our responsibility. So I think it is very important, and I hope it is bipartisan.

Senator COVERDELL. I do, too, and for the record, I think we could list every time that it has occurred.

Senator GLENN. Let me say this. I was not the one who made it partisan. I came with an open mind this morning, wanting to do something that I think is right, and suddenly, the only examples I hear are President Clinton and what he did in 1993—the only examples from anybody. That is wrong.

Senator HUTCHISON. No one mentioned the President, Senator Glenn.

Senator GLENN. They mentioned what he did in 1993.

Chairman STEVENS. Senator McCain?

Senator GLENN. I apologize to the Senator from Arizona for taking his time.

Senator MCCAIN. I will be very brief, Mr. Chairman, but I do have one serious question, and I hope it will be viewed as a nonpartisan question after I vent my partisan spleen here.

I voted against every, single one of those tax increases, I would say to my friend from Ohio, going back to when I was first here in 1984, and in 1986, 1990 and 1993, not just because they were retroactive, but that certainly did play a role in it. I would say in all candor to my dear friend from Ohio that if anything I said was offensive to him or appeared partisan, I apologize. I hope we can address this in a bipartisan fashion, and I know these are tense times, so I would like to ask I think a very relevant question to the witnesses.

If tax increases should not be retroactive, should tax cuts not be retroactive?

Senator COVERDELL. My response would be that a tax increase destabilizes and reduces the resources of the individual and the family, the business. There is no way to prepare for that. If you were going to make a tax cut retroactive, that is not destabilizing. In fact, you could even argue that it might be exceedingly beneficial to the general welfare of the country because it would expand the economy, and I do not think the standard applies both ways. One destabilizes, and one enriches.

Senator HUTCHISON. I would just say, too, that I consider that the money that a taxpayer earns belongs to the taxpayer, so that allowing the taxpayer to keep that money is a very different matter from taking the money, which is a taking of property as opposed to leaving the property in its rightful place.

Senator MCCAIN. Thank you, Mr. Chairman.

Chairman STEVENS. Senator Glenn, further questions?

Senator GLENN. No.

Chairman STEVENS. We are grateful to you both for coming to this debate. Thank you very much.

We will now go to the second panel, which includes Joseph Schmitz, a partner at Besozzi, Gavin, Craven and Schmitz, and an adjunct professor of law at Georgetown University; Nancy Mitchell, an economist and vice president of Citizens for a Sound Economy; Peter Ferrara, Americans for Tax Reform; Rick Rule, from Covington and Burling; Wayne Nelson, a private citizen; and Robert Proctor, with Southeastern Legal Foundation.

Ladies and gentlemen, we do have matters coming up on the floor this morning. We hope that you will understand if we put your statements, if you have a prepared statement, in the record in full. In any event, we hope you can keep your statements to under 10 minutes, and we appreciate your courtesy if that will be the case.

I will proceed as you are listed on the witness list, so Mr. Schmitz, you would be first—Professor Schmitz.

TESTIMONY OF JOSEPH E. SCHMITZ,[1] ESQUIRE, BESOZZI, GAVIN, CRAVEN & SCHMITZ, AND AN ADJUNCT PROFESSOR OF CONSTITUTIONAL LAW, GEORGETOWN UNIVERSITY, WASHINGTON, DC

Mr. SCHMITZ. Thank you, Mr. Chairman.

First of all, I would like to thank the Chairman for inviting me to testify today.

My name is Joseph Schmitz, and I am a partner with the firm of Besozzi, Gavin, Craven and Schmitz. I am also an adjunct professor at Georgetown University Law Center, where I teach a seminar on advanced constitutional law.

Two years ago, I represented Senators Stevens, McCain, Coverdell, Hutchison, and 38 other Members of Congress and the Washington Legal Foundation as amici curiae to the United States Supreme Court in the case of *United States* v. *Carlton*, which was mentioned earlier by the first panel. A copy of our *amici* brief is attached to my written testimony.

Before I discuss Carlton, I would like briefly to tie together a first century Roman emperor named Caligula, and 18th century British jurist named Blackstone, and our own Constitution's two explicit prohibitions against enacting laws after the fact or *ex post facto*.

Chairman STEVENS. If you can do that, I will deliver it to Senator Byrd.

Mr. SCHMITZ. I have heard Senator Byrd's testimony on Roman history.

Two thousand years ago, Emperor Caligula reportedly had difficulty balancing the budget of the Roman Empire. When his coffers were nearly empty, Caligula would raise additional revenues by writing new laws in very small characters and posting them upon high pillars. When the people failed to heed the new laws,

[1] The prepared statement of Mr. Schmitz appears on page 27.

Caligula reportedly imprisoned and/or killed them, and of course, confiscated their wealth.

By the way, Caligula was assassinated in the year 41 A.D., in his fourth year as emperor and at the ripe old age of 29.

Shortly before our own Boston Tea Party, Sir William Blackstone published in England a comprehensive treatise on English law, known as "Blackstone's Commentaries on the Laws of England." In his commentaries, Blackstone cited Caligula's method of raising revenues as an example of how not to notify the people of a new law, such notification, according to Blackstone, being an essential element of any civil law. Immediately after disparaging Caligula for ensnaring his own people through illegible laws, Blackstone writes, "There is still a more unreasonable method of notification than this, which is called making of laws *ex post facto*." All laws, according to Blackstone, "should be therefore made to commence *in futuro* and be notified before their commencement."

The drafters of the Constitution apparently read Blackstone well, and were no fans of Caligula. They included in Article I of the Constitution two explicit prohibits against *ex post facto* laws—one for Congress and one for the States.

Despite the clarity of Blackstone's commentaries, most modern scholars agree that it is not clear what the term "*ex post facto*" was understood by all the drafters of the Constitution.

We do know, however, that retroactive legislation generally was abhorred not only by Sir William Blackstone, but by most if not all other prominent English-speaking proponents of the rule of law in the 18th century.

For instance, James Iredell, later Justice of the United States Supreme Court Iredell, argued during the constitutional debates in 1787 that "*ex post facto* laws have been the instrument of some of the grossest acts of tyranny that were ever exercised."

In 1798, however, the Supreme Court construed the constitutional prohibition against State, as opposed to Federal, *ex post facto* laws as applying only to criminal-type laws. That decision turned on the historical fact that the Connecticut legislature, like Parliament, and unlike Congress, was authorized to reverse judicial decisions. That was a probate case.

Almost 200 years later, the Federal *ex post facto* clause has never been independently construed by our Supreme Court or by any other court, to my knowledge. The Federal *ex post facto* clause has always been lumped together with the State prohibition and, accordingly, limited to criminal laws in accordance with the U.S. Supreme Court's 1798 decision regarding Connecticut.

But failure to pay Federal taxes in the 20th century is a crime. Section 7203 of the Internal Revenue Code, for instance, makes it a misdemeanor "willfully to fail to pay a Federal tax, the penalty for which is up to $25,000 for individuals, $100,000 for corporations, and/or imprisonment up to 1 year." And I daresay had I willfully failed to pay my retroactively increased income taxes in 1993, I could have gone to prison for up to a year.

The Supreme Court's 1991 decision in *Cheek* v. *United States* illustrates that there is no bright line between civil and criminal tax cases and that any taxpayer who protests taxes, including retroactive taxes, by not paying them is subject to criminal penalties.

Accordingly, the constitutional prohibition against *ex post facto* laws, even if restricted to criminal-type laws, seems to apply to retroactive Federal taxes.

The Supreme Court's decision in Carlton, however, suggested that the Court is unwilling to impose any meaningful restraints on Congress' ability to enact retroactive tax increases. Carlton was a constitutional disappointment because, among other reasons, the Court completely ignored a compelling *ex post facto* argument raised by 42 Members of Congress. The Court in Carlton addressed only the due process challenge raised by Mr. Carlton in that case. Theoretically, therefore, another retroactive tax case might come up to the Court under a different provision of the Constitution, perhaps even under the Federal *ex post facto* clause which, as I have said, has never been independently and definitively adjudicated by the Supreme Court.

Carlton was also a democratic call to arms, because by ignoring the *ex post facto* argument of 42 Members of Congress, the Justices of the Supreme Court, in three separate opinions, in effect said: This issue is too hot for us to handle. It is up to the political branches or to the people to impose any restraints on retroactive Federal taxation.

The critical questions which remain for this Committee and, ultimately, for the American people are whether this Congress is willing to do better than Caligula and restrain itself from enacting retroactive tax laws, and if so, how should such restraint best be formalized.

S. 94 appears to be an excellent vehicle for addressing both questions.

Thank you.

Chairman STEVENS. Thank you very much, Professor.

Next, Ms. Mitchell, Vice President of Citizens for a Sound Economy.

TESTIMONY OF NANCY L. MITCHELL,[1] ECONOMIST AND VICE PRESIDENT FOR POLICY IMPLEMENTATION, CITIZENS FOR A SOUND ECONOMY, WASHINGTON, DC

Ms. MITCHELL. Thank you, Mr. Chairman.

Mr. Chairman, members of the Committee, my name is Nancy Mitchell, and I serve as vice president for policy implementation for Citizens for a Sound Economy, a 250,000-member public policy organization dedicated to promoting economic growth through market-based solutions to public policy problems.

I appreciate having the opportunity to testify about the effects of retroactive tax policy.

My remarks will focus on the economic effects of retroactive taxation. I realize that there are important legal and moral arguments against the practice, but for the time, I will leave those issues to the lawyers and the philosophers.

It has been stated that retroactive taxation poses few economic problems. According to conventional wisdom, the fact that a tax is imposed after the economic behavior in question has been undertaken presumably means there is no opportunity for the taxpayer's

[1] The prepared statement (with charts) of Ms. Mitchell appears on page 75.

incentives to be diminished. As a result, all the usual ill effects of taxation, particularly the impact of higher marginal tax rates, on incentives to work, save and invest are avoided because taxpayers cannot go back in time to change their economic behavior.

This analysis is true, but incomplete. There is no question that lawmakers can levy a tax on last year's output and income with complete confidence that taxpayers will be unable to go back and change the amount of working, saving, and investing that they did. Note, however, that this so-called "harmless" scenario relies on taxpayers being completely fooled by the imposition of retroactive taxes. Being "fooled" presupposes that taxpayers and the entire tax advice industry do not pay attention to what Congress does. While this may happen sometimes, in the age of C–SPAN and Rush Limbaugh, it is fairly rare.

Taxpayers certainly were not fooled by the retroactivity of the Clinton tax increase in 1993. As Chart 1, appended to my testimony, indicates, there was a huge spike in personal income in late 1992, along with a corresponding drop in early 1993.

Taxpayers all across the country, from corporate executives to future First Ladies to major league baseball players, took steps to accelerate income into the 1992 tax year because of the expectation that the incoming administration would impose a new, high tax on at least some portion of 1993 income.

Defenders of retroactive taxation, confronted by this marked shift in taxpayer behavior, might be tempted to claim that the retroactivity had no adverse consequences. Taxpayers, after all, still paid 1992 taxes on that income. What harm, therefore, was done to the Government's finances—the finances of taxpayers, unfortunately, never seemed to be a major concern.

Needless to say, if astute taxpayers were sufficiently aware of the threat of higher taxes that they engaged in massive income-shifting, then it certainly stands to reason that they also were aware enough to reduce the levels of work, saving, and investment in which they engaged.

And indeed, that is precisely what began to happen. As you can see from Chart 2, also appended to my testimony, well-to-do taxpayers began shifting money into shelters such as municipal bonds and took other steps to protect their income from the Government.

Now, to be sure, the impact of reduced incentives becomes more pronounced over time. You can see in the attached chart how "rich" taxpayers responded to the tax increases between 1992 and 1993; the amount of income reported by those earning more than $500,000 fell by some 3.5 percent, while income reported by those earning less than $500,000 rose by 2.7 percent. Nonetheless, this is evidence that retroactive taxes can have harmful economic effects.

Now, perhaps the worst economic aspect of retroactive taxes, however, is their impact on savings. Regardless of whether taxpayers know ahead of time that a retroactive tax is coming, the actual tax liability is almost certainly paid for with savings.

Considering that the only economic rationale that has ever been offered for higher taxes is that they will boost the amount of savings available for private investment, even the most ardent tax-increaser, one must assume, should recognize that a tax increase fi-

nanced out of savings will have no positive effect. And for those in the real world who understand the strong historical relationship between higher taxes and more spending, as well as the adverse impact on economic growth, this makes retroactive taxation a very self-defeating policy. In fact, I would say it is the worst of both worlds.

In the overall context of tax policy, the fact that the 1993 increase in tax rates was retroactive is a relatively minor economic problem when compared to the ongoing damage of higher tax rates and their imposition on the economy. Nonetheless, the damage that is imposed, particularly when the moral component is taken into consideration, should convince lawmakers never to travel down this path again.

The best solution would be for policymakers to adopt a flat tax. This type of system, which taxes all income once and only once, would do much to restore faith in the political system. The various deductions, exemptions and discrepancies in the current code would be removed, and with them, the political playing field for lobbyists and special interests—and by the way, the degree of certainty with which taxpayers would approach each year and income in each year would go up dramatically; they would essentially be able to predict with a very high confidence level what their tax liability would be each year.

The low rate would spur economic growth and increase compliance, and the super-majority provisions, at least in the Armey-Shelby bill, would also provide taxpayers with, again, that much-needed certainty. This is particularly worthwhile in light of the fact that, according to the Tax Foundation, we undergo a significant change to our Tax Code approximately every 1.3 years.

Thank you, and I will be happy to answer any questions.

Chairman STEVENS. Thank you very much, Ms. Mitchell.

We will now turn to Peter Ferrara, with Americans for Tax Reform.

TESTIMONY OF PETER FERRARA,[1] GENERAL COUNSEL AND CHIEF ECONOMIST, AMERICANS FOR TAX REFORM

Mr. FERRARA. Thank you, Mr. Chairman.

My name is Peter Ferrara, and I am the general counsel and chief economist at Americans for Tax Reform.

This issue is actually simple if you look at it from one perspective. When people plan to engage in a transaction, when they look to engage in a transaction, they take into account the tax considerations in adding up whether this transaction is fair or worthwhile to them, and whether they want to engage in it or not.

The problem with retroactive taxation is that once they have made the commitment to engage in this transaction, based on certain tax law, the tax law is changed for them, and they cannot go back and undo or redo that transaction. So the Government, then, is arbitrarily turning fair deals into unfair deals, good deals into bad deals, and profitable deals into losing deals. And that is why it is unfair to people, and that is why this kind of taxation can be called confiscatory taxation.

[1] The prepared statement of Mr. Ferrara appears on page 83.

It is the hallmark of a desperate, overreaching Government when they engage in this type of taxation. It is the hallmark of a Government that is taxing and spending more than its people are willing to support.

In addition to this moral problem, this unfairness factor, it does have negative economic consequences, just as Nancy Mitchell discussed. If the Government is going to be prone to undoing your transaction, if they are going to be prone to coming in after you have already made a commitment and changing it, there is an uncertainty factor built into all the economic transactions in the country. Why would you want to invest your money in a country where the Government is going to change the rules after you have already made the investment and engaged in the transaction? There would be an uncertainty premium imposed on all investments, all transactions in America, because no one knows when the Government in its wisdom is going to come in and retroactively change the rules under which those transactions were made.

That is going to, for example, cause higher interest rates because no one in America is going to lend money for some kind of economic enterprise without having compensated with a higher premium to compensate them for the risk that the Government is going to come in and take back a chunk of that later in a retroactive tax. It is going to require a higher return to investors before they are going to be willing to make an investment. That is going to mean lower rates of investment, lower rates of savings. That is going to mean lower jobs. That is going to mean lower wages over time. So it has all of those negative effects.

That is why we strongly support the proposed legislation. We think that all these retroactive taxes ought to be prohibited.

I think the point that Senator Glenn raised ought to be addressed. I do not think there is any fair situation where you go back and want to correct some kind of loophole or something for people who were, "inadvertently left out," as he suggested. If they were left out, they were left out, and they made their transactions because the law left them out. Now, you may have intended to get them, if it was inadvertent, but you did not, and they made their transactions based on your law. So if you want to correct that, it should be corrected prospectively if you intend to correct it. Otherwise, it has the same unfairness I described, the same negative economic effect. Nobody knows when the Government is going to come in and say, "We inadvertently forgot to tax you, and now we are going to tax your transactions."

So I am afraid that any such loophole in the law, as he suggested, would be exploited and would be too vague. There is no way to clearly define that, and I do not see that there is any significant scope of circumstances where that would apply.

Thank you, Mr. Chairman.

Chairman STEVENS. Thank you. We will print your complete statement in the record, along with all the others, as I said.

Next, Mr. Rick Rule, please.

TESTIMONY OF CHARLES F. "RICK" RULE, ESQUIRE, COVINGTON & BURLING, WASHINGTON, DC

Mr. RULE. Thank you, Mr. Chairman, members of the Committee. Good morning. My names is Charles F. "Rick" Rule, and I am a partner at the Washington law firm of Covington and Burling; and although I am speaking on a tax issue, I primarily practice in the area of antitrust.

My comments this morning reflect my views only and are not intended to reflect the views of my partners or any of our clients.

The staff asked me to come today as a result of a representation I undertook together with Mark Levin and others at the Landmark Legal Foundation of the National Taxpayers Union (NTU) in connection with their challenge to the constitutionality of the Omnibus Budget Reconciliation Act of 1993. Specifically, that challenge was to Section 13208 of the law, which retroactively increased the rates on certain gifts and estates, and it was that retroactivity that was being challenged.

Interestingly, in light of some of the exchanges this morning, while there have been other examples of retroactive tax increases, primarily in the area of income taxes, 13208 marked the first time since the original passage of the Federal gift tax, which was struck down by the Supreme Court, that Congress attempted to retroactively increase rates on gifts and estates. And I think one should not lose sight of the fact that there was a certain novelty in what was done in 1993, and it was that novelty that NTU challenged.

After 2 years of litigation, we in effect were unsuccessful at the district court level. We were also unsuccessful at the Court of Appeals; they affirmed the dismissal of our suit. Even though we believed and continue to believe that the merits of our argument are strong, we never got to present those merits to the court because of something known as the Anti-Injunction Act and parallel provisions in the Declaratory Judgment Act which prohibit injunctive suits by taxpayers to enjoin tax statutes for the collection of taxes.

I think what our experience points out is the difficulty—even though I think there are very good arguments concerning the unconstitutionality of retroactive taxation—the difficulty of actually bringing those claims to the court and of overcoming the rather high hurdles the courts have placed in the way of litigants.

The NTU suit focused on—although we challenged Section 13208 as a violation of the Due Process Clause—the Carlton decision that has been referred to was decided in the course of the litigation and that, for various reasons that I would be happy to go into on questioning, but I will not bore you with here, basically made it impossible given the procedural posture of our case to effectively litigate our due process claim. We did not have an *ex post facto* clause claim.

What we focused on was the fact that the retroactive imposition of the rate increase in 13208 was a direct tax, and under the Constitution, Article I, direct taxes, that is, taxes on property, have to be apportioned among the States in accordance with the Census.

At the time of the framing and adoption of the Constitution, the Framers thought that requirement that direct taxes on wealth or property be apportioned was very important to guard against taxation without representation, and as the economists and others

have noted here today, one of the "benefits" of a retroactive tax is the fact that it does not affect behavior because the events that are supposedly taxed have already occurred, and as economists have noted, the retroactive tax is indistinguishable from a capital level or a tax on property. The notion of the Framers is that unless you impose those kinds of taxes in proportion to the Census, you run a risk that the more populous, less wealthy States will in effect expropriate the wealth of the less populous, more wealthy States. So that provision was deemed very important, and there were several direct taxes imposed in the early part of our history, although there is no doubt that the apportionment requirement is burdensome, and as a result, for the last 100, 150 years, Congress has chosen not to levy a direct tax because of the difficulty of apportionment.

Of course, Congress, in the late part of the last century, did impose what the courts held to be a direct tax, that is, an income tax on income from property. It again did not apportion that. The Court struck it down, and the only reason we have an income tax today is because of the 16th Amendment, which removed the apportionment requirement as to income taxes.

At any rate, we felt that we had a very strong argument and still do believe that we have a very strong argument, but the Anti-Injunction Act is a very difficult bar for a litigant to cross. NTU had members who were adversely affected, executors of decedents' estates who were adversely affected by the tax increase. It had legatees who would be adversely affected by the tax increase, and donees.

But notwithstanding that standing to represent those taxpayers' interests, the courts in effect held that the two narrow exceptions to the Anti-Injunction Act created by the Supreme Court were really too narrow for even NTU to squeeze through because even though NTU could not bring a legal action, and even though some of its members had no direct right to bring a legal action, the fact that they had fiduciaries who could bring a legal action was enough to say that NTU should be denied its day in court.

I think the lesson that one can draw from the NTU experience is the fact that it is very difficult for Congress to ignore its obligations under the Constitution and, frankly, its moral obligation to be fair, as others have pointed out, and expect the courts to come back and clean up the mess. There is a lot of reluctance on the part of the courts to do that. The courts are very deferential to Congress on tax matters, and the AIA compounds that problem.

Therefore, something like S. 94 is very important as a recognition of Congress' constitutional responsibility and imposing restraints on it to ensure that in the future, regardless of what the record is in the past, the Congress does the right thing and does not any longer impose retroactive tax increases.

That is really all I have to say. I would be happy to answer questions of the Committee.

Chairman STEVENS. Thank you, Mr. Rule.

Our next witness is Wayne Nelson, who represents Communicating for Agriculture.

Mr. Nelson?

TESTIMONY OF WAYNE NELSON,[1] FOR HIMSELF AND ON BEHALF OF COMMUNICATING FOR AGRICULTURE, WINNER, SD

Mr. NELSON. Thank you, Mr. Chairman, members of the Committee.

My name is Wayne Nelson. I am a farmer from Winner, South Dakota, and I am also president of Communicating for Agriculture, which is a rural advocacy group representing farmers, ranchers, and rural businesses throughout all 50 states. I would like to talk about my own situation, which has been affected by retroactive taxes this year.

I farmed with my father in South Dakota until his death in 1993. We raised wheat, sunflowers, corn, and grain sorghum on our dryland farm. I own some land by myself, but a lot of the land that I farmed was owned by my father.

My father died in the spring of 1993, and in the fall of 1993, a large budget bill was passed by Congress. This legislation contained several retroactive tax measures, one of which was a 5 percent increase in income tax rates for estates. It was passed in the fall of 1993, after my father's death, but had a retroactive starting date of 2 weeks before my father's death. This additional 5 percent cost my family's estate several thousand dollars and seemed as though it was adding insult to injury because it was applied retroactively.

Additionally, now the estate is not settled, and it appears there could be an additional, up to a $10,000 charge on the 1993 return, so it means quite a bit financially to our family.

In addition to this income tax, the State also had to pay a significant amount of South Dakota State inheritance tax, as well as Federal estate taxes. To pay these taxes, more than 700 acres of land that I had farmed had to be sold. In my case, I was lucky enough that there was still some land left so I was able to stay in business, but in many cases with small businesses and farmers, after the estate taxes are paid, they are unable to stay in business; they have to sell the assets in order to pay the estate taxes.

As has been said many times, farmers live poor and die rich, and unfortunately, that is very true because they have all their money tied up in assets that are land and machinery, and they do not have readily available cash. Usually, when the estate is starting to be settled, the only way to come up with tax money to pay estate taxes is to have a sale and sell either land or machinery. That is what really causes problems.

This also puts added strain on rural areas by the loss of these businesses. State taxes are very unfair for both farmers and small business people. It seems that one generation will build up the assets, work very hard, paying income tax on that money along the way, and then, when it comes time to pass that business on to another generation, often, as I said, they have to sell the business to help pay the taxes.

Communicating for Agriculture strongly supports this legislation because of its basic fairness and because it should always be a basic right for citizens and businesses to be informed about tax policy and to be able to plan ahead. Tax planning is fundamental to

[1] The prepared statement of Mr. Nelson appears on page 84.

financial management for any business and family today, especially in farming. Retroactive tax increases inherently violate the ability of the public to have fair and prudent financial management regarding taxes.

Retroactive tax increases are bad for everyone. My personal experience has been that retroactive tax increases affect me even after my father's death.

Thank you very much for the opportunity to tell my story today, and I would be glad to try to answer any questions at the proper time.

Chairman STEVENS. Thank you very much, Mr. Nelson.

Our last witness is Robert Proctor, Managing Partner, Proctor, Felton & Atkinson, in Atlanta.

TESTIMONY OF ROBERT J. PROCTOR,[1] MANAGING PARTNER, PROCTOR, FELTON & ATKINSON, ATLANTA, GA

Mr. PROCTOR. Thank you, Mr. Chairman, members of the Committee, and Senator Coverdell. I want to thank you for having the opportunity to speak to you today on S. 94.

My name is Robert J. Proctor, and I reside in Atlanta, Georgia, where I woke up at 4 a.m. this morning. I am chairman of the board of trustees of the Southeastern Legal Foundation, which is a public interest law firm that promotes individual freedom, limited government, and capitalism.

Southeastern Legal Foundation was founded in 1976, is headquartered in Atlanta, and represents individuals, businesses and groups in litigation throughout the southeastern United States.

I am also a practicing attorney and managing partner of my law firm, Proctor, Felton & Atkinson, in Atlanta.

In appearing before you today, I am speaking for myself and not for the Foundation, as our charter prohibits us from taking positions on legislation.

In 1789, Benjamin Franklin wrote that nothing in this world is certain but death and taxes. He of course was wrong—even taxes can be uncertain, which is the problem we are here to address today.

I have represented taxpayers in the State of Georgia in numerous class action and other public interest suits in the taxation area in the past several years against the State of Georgia and various local governments in our State. I regret to say that I have not yet had the opportunity to represent taxpayers against the Federal Government on Federal taxation issues, but many of the concerns which are sought to be addressed by Senate Bill 94 arise in the State and local taxation field as well.

Even on the day that I prepared my written remarks for today, my office was working on problems in property taxes in the City of Atlanta, where the tax assessors have fallen far behind in keeping up with the assessment of newly-constructed buildings and just now are sending out reassessments going back to 1992 and 1993. In many of these cases, the property has already been sold before the reassessment arrives, but our laws put the lien on the new

[1] The prepared statement of Mr. Proctor appears on page 85.

owner as well. Just last week, our appeals court in Georgia held that these retroactive reassessments were illegal.

Coming from a background of litigation and a life spent in law, it is tempting to direct my remarks to the development of the law of retroactive taxation as it has evolved in the Federal courts of this country. I believe, however, that the Committee is probably already well-acquainted with this line of case authority, and I am cognizant of my position in the order of witnesses appearing before you today.

More fundamentally, however, it is my belief that simply because the courts allow Congress to take certain actions does not mean that those actions, when taken by this Congress, are right or equitable or just or fair. And as they say where I come from, retroactive taxation just ain't fair.

While S. 94 is worded generally, as well it should be, to include all types of retroactive taxation, it is proposed and will be understood by most Americans if it passes to apply with particular significance to income taxation, for it is income taxation by which this Government derives the vast bulk of its revenues, and it is income taxation which most directly affects most Americans.

This Committee and this Congress should bear in mind that the average American now spends about a third of his or her year and about a third of his or her income to pay income taxes to Federal, State and local governments. And it is important to include in the analysis State and local taxation, as so many of our States and local governments borrow from the Federal income taxation statutes in establishing their own income taxation schemes.

Whenever one-third of your life is affected, one tends to plan around it. And it is certainly true that Americans plan their spending, their savings, their investments and their transactions in light of the tax consequences that flow from those. It is bad enough when the rules are so complex that you have to hire a professional to interpret them. It is bad enough when the rules change dramatically virtually every year. It is intolerable, however, for the rules to change after plans have already been made.

In addition, this bill will promote responsibility in this Congress in limiting the opportunity to meet revenue needs by singling out certain classes of taxpayers for retroactive taxation, instead of spreading present revenue needs over the wide base of present tax sources.

For an example of this, we need but look at the case of *Welch* v. *Henry*, which was decided in the United States Supreme Court in 1938. In that case, the Wisconsin legislature, in order to meet what they perceived as an emergency revenue need for unemployment payments in 1935, imposed a tax on dividends which had previously been exempt. But they did not limit the tax to dividends paid after the bill was passed, or even dividends in 1935; they went all the way back to 1933. The taxpayer in question's sole taxable income was from these kinds of dividends. He duly filed a return in 1933, but owed no taxes. Then, 2 years later, he was presented with a bill for his share of the budget needs of Wisconsin in 1935.

As in so many other areas of the law beginning in the 1930's, the United States Supreme Court, which previously had refused to

allow retroactive gift taxation, did an about face and, in an opinion which stretches the bounds of credulity, approved the practice.

Of course, there were probably not that many voters in 1935 in Wisconsin who derived virtually all of their income from stock dividends. It was a particularly easy political route for the Wisconsin legislature to follow. Sure, the taxpayers affected were miffed, but my bet is they were a small minority of the voter base. Passage of S. 94 will take away the temptation and the opportunity to play political games with taxation of this type. And, if we analyze honestly the times in the past when retroactive taxation has occurred, we must admit that those games have been played.

In conclusion, passage of S. 94 is a vital part of the process of reforming taxation in the United States so as to make it simple, fair and equitable. The vast majority of Americans desperately want their Federal taxation system to be changed so that they can be freed from the incessant tax rituals they now undergo. They want a tax system that is simple, predictable, fair, intelligible, and stable.

They want something very different from what we have today.

Thank you.

Chairman STEVENS. Thank you very much, Mr. Proctor. I wish we were the tax committee; that would be a nice thing to tackle.

Let me just ask all of you one question. This is really not a bill to affect *in toto* the retroactive taxation. It really affects our conduct in the Senate in particular, where we have observed the rules of the Budget Act, and we do require automatically a super majority, or 60 votes, in the event a point of order is raised. So this is not a complete barrier to the statements that you all have made; it is a higher hurdle to go over, if you will, to pass a law such as the ones that you have been talking about. And I particularly agree with Professor Schmitz—I think that it is *ex post facto*.

Do any of you have any other suggestions about the way we might get to this problem, other than by rule? Have you thought about it that way?

Senator COVERDELL. The Constitution.

Mr. SCHMITZ. Mr. Chairman, I testified on Senator Coverdell's proposed constitutional amendment last year. I think that was a good idea, and I daresay it would probably be unanimously ratified by all 50 States if it ever got there.

Chairman STEVENS. Yes, I wish we had that jurisdiction. I agree with you. A constitutional amendment would be a clear way to do it. Short of a constitutional amendment, are there any suggestions?

Mr. PROCTOR. Mr. Chairman, since you are trying to in essence limit the ability of Congress to enact legislation in the future, I do not know of any way short of a constitutional amendment, other than a rule of this type, because otherwise, any tax bill you pass in the future would simply override any legislation that you pass today. So this would appear from my experience to be the only way to accomplish it short of a constitutional amendment.

Mr. SCHMITZ. Mr. Chairman, there is a historical precedent; it is called a tea party.

Chairman STEVENS. Well, we could close the courts, Professor. We could close the courts, if we could get to the Judiciary Commit-

tee to do it, to enforcement of any retroactive tax increase. But I am not sure they are prepared to do that.

Mr. Rule?

Mr. RULE. Mr. Chairman, I was just going to mention one thing that has occurred to us in the course of the NTU litigation, and that is the AIA, the Anti-Injunction Act, does create a lot of obstacles and makes it difficult for people like Mr. Nelson and others to challenge this or to have somebody like NTU challenge a statute that I think a lot of people feel on its face may be unconstitutional.

One suggestion—I am not sure I would say it is a recommendation—might be to look at the AIA and limit its applicability, or remove its applicability, in the case of facial challenges to the constitutionality of tax statutes. The difficulty is that even though this is a clear, easy case for the courts to address one way or the other as to whether or not a statute is constitutional or unconstitutional because it is retroactive, it is very difficult for the courts to reach it. There is a lot of litigation over procedure, and the courts never get to the issue. And again, I think it is probably best for Congress just to step up to the plate and recognize their constitutional and moral obligations, but something short of a constitutional amendment might be figuring out an easier path to the courts to challenge these kinds of statutes.

Chairman STEVENS. Mr. Nelson, having had some personal experience in terms of retroactive taxation applied to an estate of which I was administrator, I particularly appreciate your testimony. Unfortunately, we did not know you in 1994, or we might have gotten Professor Schmitz to represent you—but you would have had to go to jail to prove the point. So I think we are lucky we did not cross that bridge. But I do thank you for volunteering your time to come today.

Senator Coverdell?

Senator COVERDELL. Mr. Chairman, in the essence of time, I will just address a couple of questions to the whole panel.

Mr. Ferrara was the only member to in essence challenge the assertion that there would be certain conditions under which this should not apply. Among those of you in the legal profession, can you think of any condition that would give sustenance to Senator Glenn's worry that there may be an error or something of that nature that we might have to deal with in this legislation?

I take it, Peter, you do not agree that there is any case because generally, there is a knowledge in any transaction about what the condition is at that time.

Mr. FERRARA. The principle I would try to apply would be when the people did the transaction, and they took into account the tax consequences, if they had a rule that they were exempt under at that time, whether it was a mistake or not, it would be just as wrong to change it retroactively, and it would have the same negative economic consequences. Now, if they did not know at the time they engaged in the transaction—if you could find something that was so technical that nobody knew about it—I suppose you might be able to come up with situations, but I do not think there is a broad scope of potential situations, and you are liable to create more trouble trying to create an exemption than there really is anything meaningful to correct, because I do not see how this is

going to be drafted clearly and unambiguously so that it is not vague enough to allow other things through. So I think it is much more trouble than it is worth.

Senator COVERDELL. Robert, I particularly wanted to hear from you on that. I might say to Mr. Proctor that since you have not begun to press your case in the Federal court, that we should all encourage him, because if he could have the success rate at the Federal level that he has had at the local level, this would be a very different Government.

Mr. PROCTOR. Thank you, Senator. It is interesting that Senator Glenn raised that, because that was the argument that the United States made in the 1920's when this gift tax came in, that we passed an estate tax, but we did not have a corresponding gift tax, so smart taxpayers gave all their assets away before they died, and they were tax-exempt. So that the Congress passed the gift tax and backdated it to the effective date of the estate tax because they made a mistake. And in one of the dissenting opinions, one of the Justices said the taxpayer should have known that he was going to have to pay the tax because it was just too good to be true.

Well, my feeling is that if the Congress makes the mistake in taxing a transaction that they did not mean to tax—in other words, they took more of our money than they had to—please, correct that retroactively, which I think this bill would allow.

But if, with all of these people you all have working up here, if you make a little mistake where some of us get to keep a little bit more of our money, I think we ought to win that case. That is my feeling.

Senator COVERDELL. That goes to the question that Senator McCain asked about retroactive tax reduction.

Now, several of you have made a point that I had not taken into full weight that makes this whole process even more onerous—that there would be a conscious thought that by doing it retroactively, we would have entrapped the citizens from behavioral adjustment. That is very offensive. I really had not realized that it was a school of thought.

Ms. MITCHELL. It is not just "a" school of thought. The real reason to pass this bill is that this type of tax, a retroactive tax, is almost without question going to be paid out of savings. Virtually every economic school of thought known to man, including Marxist theory, recognizes that long-term systemic economic growth only comes through savings and investment. It is literally killing the goose that laid the golden egg, in addition to having the moral component of just, plain it is not fair. A number of us have addressed that.

I have spent the last 10 years talking about economic issues across the country, and I cannot recall another incident where I saw a more emotional response than I did to the retroactive aspect of the 1993 tax increase. The frequent response I heard from crowds was, "It is just plain un-American." There was a very strong visceral reaction. Combine that moral component with the fact that you are directly taxing savings, and it is a real problem.

Chairman STEVENS. Good statement.

Senator COVERDELL. One last question to Professor Schmitz. You have not commented on the question posed by Senator Glenn. Do

you have any particular feeling? Do you agree with the other panelists?

Mr. SCHMITZ. I agree with the other panelists. I would say if you could find an instance where not a single taxpayer relied on a provision of the tax bill, then I would say there would not be any harm in correcting that retroactively—but then there would not be any point in correcting it retroactively; right?

Senator COVERDELL. Right.

Mr. SCHMITZ. I just cannot imagine in any kind of confiscatory legislation a justification for making a retroactive change to a law.

Senator COVERDELL. In closing, Mr. Chairman, from my standpoint, I want to thank Mr. Proctor—and several of you have alluded to it—but the magnitude of remembering that we are changing retroactively matters that affect upwards of one-third to 40 percent of the financial stability of any individual or family, the proportions of that are very, very significant, and it only underscores how terribly egregious this behavior has been, no matter who did it.

I very much appreciate your efforts to have the hearing and proceed with the markup.

Chairman STEVENS. Well, thank you, Senator. I should put all of you on notice that Senator Glenn has asked that we request the administration to give us their point of view and have a report on the bill. That letter has been sent to Ms. Rivlin at OMB. The tradition of the Committee is that we not go to markup until we get a report, and we have to give them a reasonable time. We were going to go to markup next week, so I doubt we can go to markup next week; it will probably be the first markup next year when we get to this bill, unless we get a very prompt reply from OMB. If we get a reply before the markup of next week, we will put it on the agenda. Otherwise, we will wait for the first markup for the Committee in 1997.

But again, I am grateful to you. I think that you are right. I think this is a question of basic fairness for the American taxpayers and particularly those who have been involved in estates, such as Mr. Nelson, where the burden falls on the next generation to pay the tax. I think that is extremely unfair application of the tax laws, and so I am very much committed to working with you, Senator Coverdell, to see that this bill is considered by the Senate as soon as possible.

Again, my thanks to all of you for coming today.

The Committee stands adjourned.

[Whereupon, at 10:55 a.m., the Committee was adjourned.]

APPENDIX

104TH CONGRESS
1ST SESSION

S. 94

To amend the Congressional Budget Act of 1974 to prohibit the consideration of retroactive tax increases.

IN THE SENATE OF THE UNITED STATES

JANUARY 4, 1995

Mr. COVERDELL (for himself, Mrs. HUTCHISON, Mr. SMITH, Mr. LOTT, Mr. KEMPTHORNE, Mr. MCCAIN, and Mr. WARNER), introduced the following bill; which was read twice and referred jointly pursuant to the order of August 4, 1977, to the Committees on the Budget and Governmental Affairs, with instructions that if one committee reports, the other committee have thirty days to report or be discharged

A BILL

To amend the Congressional Budget Act of 1974 to prohibit the consideration of retroactive tax increases.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. AMENDMENTS TO THE CONGRESSIONAL BUDGET ACT OF 1974.

(a) IN GENERAL.—Title III of the Congressional Budget Act of 1974 is amended by adding at the end the following:

"PROHIBITION ON THE CONSIDERATION OF RETROACTIVE TAX INCREASES

"SEC. 314. (a) IN GENERAL.—It shall not be in order in the House of Representatives or the Senate to consider any bill, joint resolution, amendment, motion, or conference report, that increases a tax and applies such increase to taxable years beginning before the date of the enactment of the law.

"(b) INCREASES A TAX.—The term 'increases a tax' shall include a change in any rate of tax, deduction, exemption, credit, exclusion, or similar change to the Internal Revenue Code of 1986 that will result in an obligation to pay a larger tax.".

(b) SUPERMAJORITY POINT OF ORDER.—Subsections (c) and (d) of section 904 of the Congressional Budget Act of 1974 are amended by inserting "314," after "313,".

Joseph E. Schmitz, Esq.
Senate Testimony
December 7, 1995

Before the Senate Committee on Governmental Affairs regarding S.94, introduced by Senator Coverdell (for himself, Mrs. Hutchison, Mr. Smith, Mr. Lott, Mr. Kempthorne, Mr. McCain, and Mr. Warner) to amend the Congressional Budget Act of 1974 to prohibit the consideration of retroactive tax increases

"PROHIBITION ON THE CONSIDERATION OF RETROACTIVE TAX INCREASES

S.94: "(a) IN GENERAL. -- It shall not be in order in the House of Representatives or the Senate to consider any bill, joint resolution, amendment, motion or conference report, that increases a tax and applies such increase to taxable years beginning before the date of the enactment of the law.

"(b) INCREASES A TAX -- The term 'increases a tax' shall include a change in any rate of tax, deduction, exemption, credit, exclusion, or similar change to the Internal Revenue Code of 1986 that will result in an obligation to pay a larger tax."

First of all, I would like to thank Senator Stevens for inviting me to testify today. My name is Joseph Schmitz, and as an attorney here in Washington I represented the Washington Legal Foundation, Senator Stevens, and 41 other members of Congress in an *amici curiae* brief to the United States Supreme Court in the 1994 retroactive federal tax case called *United States v. Carlton*. A copy of our *amici* brief in the *Carlton* case is attached to my written testimony. In addition to practicing law, I am an Adjunct Professor of Law at Georgetown University Law Center, where I teach an advanced Constitutional Law seminar.

The Supreme Court's decision in *Carlton* suggests that the Court is unwilling to impose any meaningful restraints on Congress' ability to enact retroactive tax increases. In *Carlton*, the Supreme Court upheld a tax amendment enacted by Congress in 1987, effective back to 1986 -- thereby totally frustrating one of Mr. Carlton's investments in the meantime. A federal appeals court in California overturned the retroactive law, calling it "so harsh and oppressive as to transgress the constitutional limitation." According to the Supreme Court in *Carlton*, however, the due process clause of the Constitution requires only that "the retroactive application of a statute [be] supported by a legitimate legislative purpose furthered by rational means."

The Supreme Court's decision in *Carlton* was both a constitutional disappointment and a democratic call to arms for anyone committed to the principle of the rule of law. Shortly after *Carlton*, Senator Coverdell proposed a constitutional amendment that would have stated: "No Federal tax shall be imposed for the period before the enactment of the tax." Hearings were held by the Senate Judiciary Subcommittee on the Constitution on August 4, 1994,

apparently with no further action on the proposed constitutional amendment. S. 94 is the first attempt to revisit the issue.

Carlton was a constitutional disappointment because, among other reason, the Court completely ignored a compelling *ex post facto* clause argument raised by 42 Members of Congress. The Court in *Carlton* addressed only the due process challenge raised by Mr. Carlton in that case. Theoretically, therefore, another retroactive tax case might come up to the Court under a different provision of the Constitution, perhaps even under the federal *ex post facto* clause, which, as I will discuss today, has never been independently and definitively adjudicated by the Supreme Court.

Carlton was a democratic call to arms because the Justices of the United States Supreme Court, in three opinions, in effect, said: "This issue is too hot for us to handle -- it's up to the political branches or to the people to impose any restraints on retroactive federal taxes."

The critical questions which remain for this Committee and ultimately for the American people are: (1) whether this Congress is willing to restrain itself from enacting retroactive tax laws; and, if so, (2) how should such restraint best be formalized? S.94 appears to be an excellent vehicle for addressing both questions.

Absent the kind of restraint envisioned in S.94, retroactive taxation is the type of capricious government intervention into the affairs of individuals that is blatantly inimical to the liberal ideals of our constitutional form of democracy. One of the most fundamental principles of a legal system based on the rule of law is predictability. My *amici* brief in *Carlton* addressed in depth the jurisprudential underpinnings of this principle. Suffice it to say, retroactive taxes make the consequences of economic decisions uncertain. Each investment is like a roll of the dice. In this regard, I'm reminded of the definition of "plunder" in an old political dictionary: "to take the property of another without observing the decent and customary reticences of theft."

The Framers of our Constitution were well aware of the pernicious effects of retroactive laws generally. The federal Constitution imposes a flat restriction on Congress that: "No . . . *ex post facto* law shall be passed." U.S. CONST. art. I, § 9. Most modern scholars agree, however, that records of the constitutional debate do not elicit a consistent understanding of what the term "*ex post facto*" was understood at that time to entail. This type of linguistic shortfall undoubtedly comes as no surprise to members of this Committee.

We *do* know, however, that retroactive legislation generally was abhorred by proponents of the rule of law in the Eighteenth Century. For instance, James Iredell (later a Justice of the United States Supreme Court) argued during the debates in 1787 that "*Ex post facto* laws . . . have been the instrument of some of the grossest acts of tyranny that were ever exercised."

The prohibition against state, as opposed to federal, *ex post facto* laws (Art. I, § 10) has been construed by the U.S. Supreme Court as applying only to criminal-type laws. *See Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798)). Almost two hundred years later, the federal *ex post facto* clause (Art. I, § 9) has never been independently construed by the Supreme Court -- or by any other court to my knowledge. The federal *ex post facto* clause has always been lumped together with the state prohibition, and accordingly limited to criminal laws. Courts have held, in effect, that because the state prohibition against *ex post facto* laws applies only to criminal laws, the federal prohibition can extend no further.

This leap of logic has no constitutional foothold, and it is especially troubling because the Framers' debate about the *state* clause apparently turned on an erroneous reading of William Blackstone's 1765 *Commentaries on the Laws of England*, the most authoritative legal treatise at the time. During the constitutional debate Mr. Dickenson of New Jersey claimed to have reviewed Blackstone's Commentaries, and to have concluded that Blackstone considered the term "*ex post facto*" to apply only to criminal laws.[1] But Mr. Dickenson's conclusion was patently wrong -- and I attempted to set the record straight last year, during the hearings on Senator Coverdell's proposed constitutional amendment, by submitting for the record a copy of the full text of William Blackstone's 1765 discussion of *ex post facto* laws. A copy of the same excerpt is attached to my written testimony to this Committee.

In his 1765 *Commentaries*, William Blackstone addressed the concept of *ex post facto* laws in his introductory section on "The Nature of Laws in General." Following a scholarly discussion of divine law and natural law, Blackstone then addressed man-made laws, which he called "municipal" or "civil" laws. According to Blackstone, *all* man-made law that imposed a duty upon individuals, whether civil or criminal, had to be "prescribed," *i.e.*, written in advance and "notified to the people who are to obey it."

The following passage is what Blackstone wrote about *ex post facto* laws, which Mr. Dickenson of New Jersey apparently cited in error as authority for the proposition that the term "*ex post facto*" applies only to criminal laws:

> [Law] is likewise "a rule prescribed." Because a bare resolution, confined in the breast of the legislator, without manifesting itself by some external sign, can never be properly a law. It is requisite that this resolution be notified to the people who are to obey it.... [I]t is incumbent on the promulgators to do it in the most public and perspicuous manner; not like Caligula, who (according to Dio Cassius) wrote his laws

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[1] See J. Madison "Records of the Federal Convention," 3 *The Founders' Constitution* 347 (P. Kurland and R. Lerner eds. 1987) ("Mr. Dickenson mentioned to the House that on examining Blackstone's Commentaries, he found that the terms 'ex post facto' related to criminal cases only; that they would not consequently restrain the States from retrospective laws in civil cases, and that some further provision for this purpose would be requisite.").

> in a very small character, and hung them upon high pillars, the more effectually to ensnare the people. There is still a more unreasonable method than this, which is called making of laws *ex post facto*; when *after* an action is committed, the legislator then for the first time declares it to have been a crime, and inflicts a punishment upon the person who has committed it; here it is impossible that the party could foresee that an action, innocent when it was done, should be afterwards converted to guilt by a subsequent law; he had therefore no cause to abstain from it; and all punishment for not abstaining must of consequence be cruel and unjust.[2] All laws should be therefore made to commence *in futuro*, and be notified before their commencement; which is implied in the term "*prescribed*."

W. Blackstone, "Introduction: Of the Nature of Laws in General," *Commentaries on the Laws of England* 45-46 (1765).

Even assuming *arguendo* an original intent by our Framers to distinguish between civil and criminal retroactive laws, such a distinction does not hold up in modern retroactive tax cases. Although violations of tax laws are usually thought of as civil offenses, tax protesters can face criminal charges and even be sentenced to prison. The recent Supreme Court case *Cheek v. United States*, 111 S. Ct. 604 (1991), illustrates that there is no "bright line" between civil and criminal tax cases, and that one who protests retroactive taxes by not paying them would be subject to criminal penalties.[3] The rationale for barring *ex post facto* laws, even if restricted only to criminal-type laws, thus applies to retroactive tax laws.

Since the Supreme Court declined to deal with retroactive taxation effectively in *Carlton*, and the last Congress was unwilling to move Senator Coverdell's proposed constitutional amendment out of Committee, it is now up to this Congress to restrain both itself and future Congresses from the pernicious temptation to raise revenues by taxing past activities. S.94 appears to be a good start.

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[2] [Blackstone's Footnote:] Such laws among the Romans were denominated *privilegia*, or private laws, of which Cicero *de leg*, 3.19. and in his oration *pro domo*, 17. thus speaks; "*Vetant leges Sacratae, vetant duodecim tabulae, leges privatis hominibus irrogari; id enim est privilegium. Nemo unquam tulit, nihil est crudelius, nihil perniciosius, nihil quod minus haec civitas ferre possit.*"

[3] Section 7203 of the Internal Revenue Code is a misdemeanor offense carrying a penalty of up to $25,000 for individuals ($100,000 for corporations) and/or imprisonment up to one year for "wilful failure to . . . pay tax." Several federal Courts of Appeals have ruled that "absent exceptional circumstances, mere unavailability of liquid assets does not excuse criminal liability under 26 U.S.C. § 7203." *United States v. Ausmus*, 774 F.2d 722, 725 (6th Cir. 1985) (citing *United States v. Tucker*, 686 F.2d 230 (5th Cir.), *cert. denied*, 459 U.S. 1071, 103 S. Ct. 492. 74 L.Ed.2d 634 (1982)). *See also United States v. Lewis*, 671 F.2d 1025, 1028 (7th Cir. 1982).

Joseph E. Schmitz, Esq.
Script of Senate Testimony
December 7, 1995

Before the Senate Committee on Governmental Affairs regarding S.94, introduced by Senator Coverdell (for himself, Mrs. Hutchison, Mr. Smith, Mr. Lott, Mr. Kempthorne, Mr. McCain, and Mr. Warner) to amend the Congressional Budget Act of 1974 to prohibit the consideration of retroactive tax increases

First of all, I would like to thank Chairman Stevens for inviting me to testify today. My name is Joseph Schmitz; I am a partner in the law firm of Besozzi, Gavin, Craven & Schmitz. I am also an Adjunct Professor of Law at Georgetown University Law Center, where I teach a seminar in advanced Constitutional Law.

Two years ago, I represented Senators Stevens, McCain, Coverdell, and Hutchison, 38 other members of Congress, and the Washington Legal Foundation as *amici curiae* to the United States Supreme Court in the retroactive federal tax case called *United States v. Carlton*. A copy of our *amici* brief is attached to my written testimony.

Before I discuss *Carlton*, I would like briefly to tie together a First Century Roman emperor named Caligula, an Eighteenth Century British jurist named Blackstone, and our own Constitution's two explicit prohibitions against enacting laws after the fact, or *ex post facto*.

Two thousand years ago, Emperor Caligula reportedly had difficulty balancing the budget of the Roman Empire. When his coffers were nearly empty, Caligula would raise additional revenues by writing new laws in very small characters and posting them upon high pillars. When the people failed to heed these laws, Caligula reportedly imprisoned and/or killed them, and, of course, confiscated their wealth. By the way, Caligula was assassinated in the year 41 A.D., in his fourth year as Emperor and at the ripe old age of 29.

Shortly before the Boston Tea Party, Sir William Blackstone published in England a comprehensive treatise on English law known as Blackstone's *Commentaries on the Laws of England*. In his *Commentaries*, Blackstone cites Caligula's method of raising revenues as an example of how <u>not</u> to notify the people of a new law -- such notification, according to Blackstone, being an essential element of any civil law. Immediately after disparaging Caligula for "ensnaring" his own people through illegible laws, Blackstone writes: "There is still a more unreasonable method [of notification] than this, which is called making of laws *ex post facto*." "All laws," according to Blackstone, "should be therefore made to commence *in futuro*, and be notified before their commencement."

The drafters of the Constitution apparently read Blackstone well -- and were no fans of Caligula. They included in Article I of the Constitution two explicit prohibitions against *ex post facto* laws, one for Congress and one for the States. Despite the clarity

of Blackstone's *Commentaries*, most modern scholars agree that it is not clear what the term "*ex post facto*" was understood by the drafters to entail.

We do know, however, that retroactive legislation generally was abhorred not only by Sir William Blackstone, but by most if not all other prominent English-speaking proponents of the rule of law in the Eighteenth Century. For instance, James Iredell (later a Justice of the United States Supreme Court Iredell) argued during the constitutional debates in 1787 that "*Ex post facto* laws . . . have been the instrument of some of the grossest acts of tyranny that were ever exercised."

In 1798, however, the Supreme Court construed the constitutional prohibition against state -- as opposed to federal -- *ex post facto* laws as applying only to criminal-type laws. That decision, involving a probate dispute in Connecticut, turned on the historical fact that the Connecticut legislature -- like Parliament and unlike Congress -- was authorized to reverse judicial decisions. [*See Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798).] Almost two hundred years later, the federal *ex post facto* clause has never been independently construed by the Supreme Court -- or by any other court to my knowledge. The federal *ex post facto* clause has always been lumped together with the state prohibition, and accordingly limited to criminal laws in accordance with the U.S. Supreme Court's 1798 decision regarding Connecticut.

But failure to pay federal taxes in the Twentieth Century is a crime. Section 7203 of the Internal Revenue Code, for instance, makes it a misdemeanor willfully to fail to pay a federal tax, the penalty for which is up to $25,000 for individuals ($100,000 for corporations) and/or imprisonment up to one year. And I dare say, had I willfully failed to pay my retroactively increased income taxes for 1993, I could have gone to prison for a year.

The Supreme Court's 1991 decision in *Cheek v. United States*, 498 U.S. 192 (1991), illustrates that there is no "bright line" between civil and criminal tax cases, and that one who protests retroactive taxes by not paying them is subject to criminal penalties. Accordingly, the constitutional prohibition against *ex post facto* laws, even if restricted to criminal-type laws, should apply to retroactive federal tax laws.

The Supreme Court's decision in *Carlton*, however, suggests that the Court is unwilling to impose any meaningful restraints on Congress' ability to enact retroactive tax increases. *Carlton* was a constitutional disappointment because, among other reason, the Court completely ignored a compelling *ex post facto* argument raised by 42 Members of Congress. The Court in *Carlton* addressed only the due process challenge raised by Mr. Carlton in that case. Theoretically, therefore, another retroactive tax case might come up to the Court under a different provision of the Constitution, perhaps even under the federal *ex post facto* clause, which, as I have said, has never been independently and definitively adjudicated by the Supreme Court.

Carlton was also a democratic call to arms because by ignoring the *ex post facto* argument of 42 Members of Congress, the Justices of the United States Supreme Court, in three separate opinions, in effect, said: "This issue is too hot for us to handle -- it's up to the political branches or to the people to impose any restraints on retroactive federal taxes."

The critical questions which remain for this Committee and ultimately for the American people are: (1) whether this Congress is willing to do better than Caligula and restrain itself from enacting retroactive tax laws; and, if so, (2) how should such restraint best be formalized? S.94 appears to be an excellent vehicle for addressing both questions.

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No. 92-1941

IN THE
Supreme Court of the United States
October Term, 1993

UNITED STATES OF AMERICA,
Petitioner,

v.

JERRY W. CARLTON,
Respondent.

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On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1993

No. 92-1941

UNITED STATES OF AMERICA,

Petitioner,

v.

JERRY W. CARLTON,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR *AMICI CURIAE* IN SUPPORT OF RESPONDENT

INTERESTS OF *AMICI CURIAE*

The interests of *amici curiae* Washington Legal Foundation, *et al.*, are set forth in the accompanying motion for leave to file this brief.

STATEMENT OF THE CASE

In the interest of judicial economy, *amici* adopt the statement of the case in respondent's brief. The following summarized facts are pertinent to *amici*'s argument.

In September 1986, the 99th Congress enacted, as part of the "Tax Reform Act of 1986," Pub. L. No. 99-514, 100 Stat. 2085, a provision codified as 26 U.S.C. § 2057 (repealed 1989), which allowed an estate to deduct from the value of the decedent's gross estate half of the

"qualified proceeds" of a "qualified sale" of certain securities to an Employee Stock Ownership Plan ("ESOP"). The 99th Congress adjourned on October 18, 1986, and four days later, on October 22, 1986, the Tax Reform Act of 1986, including section 2057, became law.

In December 1986, in specific reliance on the new "ESOP proceeds deduction" provision contained in section 2057, Jerry W. Carlton, Executor for the Will of Willametta K. Day, purchased 1,500,000 shares of MCI stock for a total of $11,206,000. He promptly sold the shares to the MCI ESOP for $10,575,000. It has been conceded below that but for the section 2057 deduction, Carlton would not have sold the shares at $631,000 below his purchase price.

Later that month, the sale to the MCI ESOP having been irrevocably completed, Carlton filed the estate tax return, deducting $5,287,500 from the gross estate pursuant to the ESOP proceeds deduction contained in section 2057.

In January 1987, the Internal Revenue Service ("IRS") issued an advance version of a notice that it would not recognize an ESOP proceeds deduction under the Tax Reform Act of 1986 under circumstances applicable to Carlton's transaction. In February 1987, a bill was introduced in the newly elected and substantially transformed 100th Congress (the majority in the Senate had shifted from the Republicans to the Democrats) to codify the IRS's restrictions. Finally, in December 1987, an amendment labeled "Congressional Clarification of Estate Tax Deduction for Sales of Employer Securities," was enacted as part of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330, which purported to conform the Tax Reform Act of 1986 to "the original intent of Congress." H.R.Rep. No. 100-391, 100th Cong., 1st Sess., Pt. II, at 1045, *reprinted in* 4 U.S.C.C.A.N. 2313-1, 2313-661 (1987).

After an IRS audit, Carlton paid an estate tax deficiency resulting from, *inter alia*, the retroactive application of the 1987 amendment. Carlton filed a refund claim for that part of the deficiency attributable to the ESOP proceeds deduction. The IRS denied the claim. Carlton then filed an action in federal district court seeking a refund of the taxes attributable to the section 2057 deduction, plus interest, costs and attorneys' fees. The parties below agreed that, if the 1987 amendment could not be retroactively applied consistently with due process, the estate was entitled to the section 2057 deduction as passed in 1986; conversely, if the amendment could be retroactively applied, Carlton could not claim the ESOP proceeds deduction.

Upon cross motions for summary judgment, the district court ruled against Carlton. The Ninth Circuit reversed and remanded on the grounds that "the 1987 amendment . . . , as applied to the transaction at issue here, violated the Due Process Clause of the Fifth Amendment." *Carlton v. United States*, 972 F.2d 1051, 1062 (9th Cir. 1992).

SUMMARY OF ARGUMENT

This case is not about tax evasion; it is about a taxpayer's response to a tax incentive written into law by one Congress, the wisdom of which was reconsidered by a later and substantially recomposed Congress. *Amici* submit that the reconsidered policy may be legitimately applied only to transactions that had not yet been completed. Retroactive legislative changes purporting to affect transactions that have irrevocably closed, as in this case, are pernicious to the concept of ordered liberty. Accordingly, *amici* urge the Court to affirm the Ninth Circuit's holding, and in so doing to clarify the rule of law underlying the current "so harsh and oppressive" due process test for retroactive taxation. It is the experience of *amici*, who include 42 Members of Congress, that the test as currently phrased provides little guidance as to the

outer bounds of Congress' constitutional power to impose retroactive taxes.

To assert that retroactivity is disfavored in the American legal tradition is a gross understatement. Two centuries ago, retroactive laws were considered by most relevant authorities (each discussed *infra*) to be "contrary to the first principles of the social compact," "against natural right," "equally unjust in civil as in criminal cases," "the instrument of some of the grossest acts of tyranny that were ever exercised," "highly injurious," "oppressive," "pernicious," "the height of injustice," "repugnant to common justice," and/or "wrong."

Retroactive taxation is fundamentally antithetical to the "rule of law," which in a free society permits individuals to plan and conform their lives in accordance with ascertainable rules. Retroactive tax law -- by definition not ascertainable in advance -- thus go to the heart of ordered liberty, a fundamental, procedural, civil right of citizens which may be overridden only by the most compelling of legislative purposes.

Amici urge the Court tc look closely not only at the due process clauses, but also at the federal *ex post facto* clause, as well as other constitutional and historical indicia, for insight into the meaning of the due process clause upon which the Ninth Circuit's decision rests. *Amici* believe the constitutional text and all available indicia demonstrate that the framers and ratifiers of the Constitution intended to prohibit the type of retroactive tax law at issue in this case.

Accordingly, *amici* urge the Court to adopt the following bright-line constitutional test for retroactive federal taxation: retroactive application of a federal tax law is *per se* unconstitutional as to completed transactions and otherwise presumptively unconstitutional unless necessary to achieve a compelling legislative purpose independent of the desire to raise additional revenues.

ARGUMENT

I. RETROACTIVE TAXES ARE ANTITHETICAL TO THE RULE OF LAW

The Solicitor General argues that the three-part due process formula utilized by the Ninth Circuit,[1] which barred retroactive application of the amended federal tax law because it was "so harsh and oppressive," lacks a foundation in the Constitution. United States Brief at 10, 19-29. But the Solicitor General suggests no meaningful alternative. Essentially, the Solicitor General proposes that the Court eliminate all substance from the current constitutional tests for retroactive federal taxes.

Amici emphatically object to this proposal, which, as explained below, is antithetical to the rule of law and demonstrably repugnant to the intent of the framers and ratifiers of the United States Constitution. *Cf.* W. Blackstone, 1 *Commentaries on the Laws of England* 46 (1765) (retroactive laws are procedurally "more unreasonable" than those of "Caligula, who (according to Dio Cassius) wrote his laws in a very small character, and hung them up upon high pillars, the more effectively to ensnare the people").

A. The Current Retroactivity Test for Federal Taxation is Not a Clear Rule of Law

The foremost problem with retroactive legislation is that it is inimical to the Rule of Law. In *Marbury v. Madison*, Chief Justice John Marshall stressed that "[t]he government of the United States has been emphatically termed a government of laws, and not of men." 5 U.S. (1

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[1] The Ninth Circuit's test looks to: (i) whether the taxpayer had "actual or constructive notice that the tax statute would be retroactively amended," (ii) whether the taxpayer relied "to his detriment on the pre-amendment tax statute," and (iii) whether "such reliance [was] reasonable." *Carlton v. United States*, 972 F.2d at 1059.

Cranch) 137, 163 (1803).[2] Chief Justice Marshall later admonished that "the power to tax involves the power to destroy." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819).

. When addressing challenges to retroactive civil legislation, modern courts typically resort to a "minimum scrutiny" due process balancing test: "Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches . . . ." *Pension Benefit Guarantee Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729 (1984). In the tax context, this Court has stated that "we must 'consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.'" *United States v. Hemme*, 476 U.S. 558, 568-69 (1986) (quoting *Welch v. Henry*, 305 U.S. 134, 147 (1938)). It is the experience of *amici* that this test provides little guidance as to the outer bounds of Congress' constitutional power to impose retroactive taxes. *See generally* Note, *Has Due Process Struck Out? The Judicial Rubberstamping of Retroactive Economic Laws*, 42 *Duke L.J.* 1069 (March 1993).

If the Solicitor General's position is accepted, this Court's retroactivity caselaw will have evolved into a blatant "rule of men," dependent upon which judge analyzes the case -- as one ancient authority described it,

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[2] *See* S. von Pufendorf, VII *De Jure Naturae et Gentium: Libri Octo* Ch. VI, § 11 (1688) (C.H. & W.A. Oldfather trans. 1934) ("[I]t is clear in what sense is to be taken the statement of the ancient Greek writers on politics and their followers, namely, that the government of a state should be committed to laws rather than to men. For that can have no other fit meaning than this: Care should be taken that those who rule should govern the commonwealth according to the direction of established laws, rather than by their own private and uncircumscribed pleasure." (Citation omitted)).

the legal equivalent of "a mariner's compass without a skipper to direct a ship." Pufendorf, *supra*, Ch. VI, § 11. The dissenting opinion below, applying the same caselaw to the same facts, proves the propensity of the current due process test to breed subjective judgments. *Compare* 972 F.2d at 1061 ("the estate's reliance on the plain language of [the ESOP proceeds deduction] was reasonable") *with* 972 F.2d at 1065 (Norris, J., dissenting) ("I [would not] find his reliance on the statute as originally passed to have been reasonable"). *Amici* implore this Court to clarify the constitutional rule of law for retroactive federal tax legislation, thereby providing both a pilot and stars by which to steer this vessel in the armada of constitutional due process caselaw.

B. The Solicitor General's Reasoning Begs the Question of Retroactivity

All legislation affecting individual rights must be "justified by a rational legislative purpose." *Pension Benefit Guarantee Corp. v. R.A. Gray & Co.*, 467 U.S. at 730. But the "rational legislative purpose" that justifies the prospective application of a law cannot *per se* justify retroactive application of the law. *Id.* ("retroactive legislation does have to meet a burden not faced by legislation that has only future effects"). *A fortiori*, retroactivity cannot be sustained by a legislative purpose that merely describes the retroactivity, *i.e.* that the retroactive law is "designed 'to bring the revenue loss in line with the original estimate and Congressional intent.'" United States Brief at 6, *citing* H.R. Rep. No. 391, 100th Cong., 1st Sess., Pt. II, at 1045.

The Solicitor General confuses "interest," "objective," and "purpose" in the following illogical sequence:

- "Congress unquestionably has a legitimate *interest* in designing revenue laws to fairly allocate to taxpayers the burdens and benefits of national fiscal policies and to prevent evasion of those laws 'by the vigilant and ingenious.'" United States Brief at 15

(quoting Justice Brandeis' dissent in *Untermyer v. Anderson*, 276 U.S. 440, 450-51 (1928)) (emphasis added);

- "If an unintended loophole is written into an enacted statute, and if Congress acts promptly to correct that error through curative legislation, it cannot be said that retroactive correction of the error lacks a rational relationship to the government's legitimate legislative *objective*." United States Brief at 15 (emphasis added);

- "A curative, retroactive statute rationally designed to accomplish that legitimate *purpose* satisfies the requirements of due process." United States Brief at 15 (emphasis added).

This reasoning has at least three fatal flaws. First, it is premised on the mistaken idea that "tax avoidance" is the same as "tax evasion." Taxpayers in the United States have a legal right to avoid taxes "by means which the law permits." As Judge Learned Hand explained in *Helvering v. Gregory*: "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465, 469 (1935) (Sutherland, J.) ("The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.") (internal citations omitted). That Congress may have a legitimate interest in preventing tax evasion is wholly irrelevant to this case, which involved legislatively-induced tax avoidance.

Second, and more fundamentally, the Solicitor General's reasoning begs the question of retroactivity in disregard of this Court's admonition that "the retroactive application of the legislation [must] itself [be] justified by

a rational legislative purpose." 467 U.S. at 730.[3] The Solicitor General neither attempts to justify the retroactive application by necessity -- a central component of the Court's reasoning in *Pension Benefit Guarantee Corp.*[4] -- nor disputes that whatever legislative purposes underlie the 1987 amendment could have been achieved through purely prospective legislation.

In effect, the Solicitor General argues that individuals who engage in lawful tax avoidance can later be taxed retroactively for no other reason than to raise more revenues. On this rationale, Congress could, for instance, pass a law to tax inheritances retroactive to 1789, and

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[3] This sequence can also be refuted as a logical fallacy known as the "fallacy of the undistributed middle," whereby the term "legislation" is the undistributed predicate of the following two premises: (A) all constitutional federal tax laws are legislation; and (B) all curative enactments are legislation. From these two premises, the Solicitor General argues that because (C) this law is a curative enactment, therefore (D) this law is a constitutional federal tax law. But the sorites (series of incomplete syllogisms) breaks down because the middle term of the first series (legislation) is undistributed (some legislation is curative and some legislation is constitutional, but not all curative legislation is constitutional -- this is the critical point the Solicitor General's argument misses).

[4] *See Pension Benefit Guarantee Corp.*, 467 U.S. at 730-31 ("One of the primary problems Congress identified under ERISA was that the statute encouraged employer withdrawals from multiemployer plans. And Congress was properly concerned that employers would have an even greater incentive to withdraw if they knew that legislation to impose more burdensome liability on withdrawing employers was being considered. . . . Withdrawals occurring during the legislative process not only would have required that remaining employers increase their contributions to existing pension plans, but also could have ultimately affected the stability of the plans themselves. Congress therefore utilized retroactive application of the statute to prevent employers from taking advantage of a lengthy legislative process and withdrawing while Congress debated necessary revisions in the statute. Indeed, as the amendments progressed through the legislative process, Congress advanced the effective date chosen so that it would encompass only that retroactive time period that Congress believed would be *necessary to accomplish its purposes.*" (Emphasis added)).

justify the retroactive tax on the need to pay the federal debt or to balance the federal budget.

Necessity, however, was the only excuse countenanced at the time of the drafting and ratification of the Constitution for an exception to the general rule against *ex post facto* laws. And legal necessity can never be equated with political expedience. During the constitutional debate, James (later Justice) Iredell made the following observations about *ex post facto* laws being tolerable only in cases of "invincible necessity":

> *Ex post facto* laws may sometimes be convenient, but that they are ever absolutely necessary I shall take the liberty to doubt, till that necessity can be made apparent. Sure I am, they have been the instrument of some of the grossest acts of tyranny that were ever exercised, and have this never failing consequence, to put the minority in the power of a passionate and unprincipled majority, as to the most sacred things, and the plea of necessity is never wanting where it can be of any avail.

Iredell, *Observations on George Mason's Objections to the Federal Constitution*, in *Pamphlets on the Constitution of the United States: Published During Its Discussion by the People 1787-1788* 333, 368 (P. Ford ed. 1888). The Solicitor General has not pled necessity because there was no "invincible necessity" for the retroactive application of the 1987 "Congressional Clarification of Estate Tax Deduction for Sales of Employer Securities."

Finally, the Solicitor General's reasoning casually disregards statutory text in favor of contradictory "legislative intent,"[5] in an effort to forge a justifying

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[5] This case is not like *Helvering v. Gregory*, *supra*, where the Court was interpreting arguably consistent text and legislative intent. 293 U.S. at 469 (focussing on "whether what was done, apart from the tax motive, was the thing which the *statute* intended" (emphasis

legislative purpose *for retroactive legislation* that bears little or no relation to an enumerated grant of power in the Constitution, presumably in this case to the power enumerated in Article I, Section 8, "[t]o lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States." U.S. Const. art. I, § 8, cl. 1; *see United States v. Butler*, 297 U.S. 1, 64 (1936).

Were the Court to adopt the Solicitor General's logic, Congress could with impunity pass laws that, for instance, permit tax deductions for political contributions, but then retroactively change the law when Members of Congress realize, *post hoc*, that: (1) the contributions overwhelmingly favored anti-incumbency; (2) the revenues lost vastly exceeded expectations; or (3) both. This hypothetical is not far off from what transpired in this case. The fundamental question in the hypothetical, as well as in this case, is this: Where in the Constitution did the States respectively or the people cede such power to Congress? *See Butler*, 297 U.S. at 63 ("The question is not what power the federal government ought to have, but what powers in fact have been given by the people."), *quoted in New York v. United States*, ___ U.S. ___, ___, 112 S. Ct. 2408, 2418 (1992).

The Solicitor General ignores this fundamental question. Instead, he asks this Court to confer upon Congress, in effect, "[a]n unlimited power to make any and everything lawful which the legislature might see fit to call taxation, . . . plainly stated, an unlimited power to

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added)). When, as in this case, alleged "legislative intent" conflicts with the actual words enacted into law, the text controls. *See St. Martin Evangelical Church v. South Dakota*, 451 U.S. 772, 790 (1981) (Stevens, J., concurring) (although legislative history may offer evidence of contrary intent, the statutory text may "simply fail[] to give effect to that intention."); *cf. United States v. Heth*, 3 Cranch 399, 409 (1806) (Johnson, J.) (ambiguous statutory "words should be taken most strongly '*contra proferentum*'"); 3 Cranch at 413 (Paterson, J.) ("[T]he words of a statute, if dubious, ought . . . to be taken most strongly against the law makers.").

plunder the citizen." T. Cooley, "The Power of Taxation," *Constitutional Limitations* 488 (1868). *Amici* believe the American people deserve better -- and are entitled to better under *their* Constitution.

II. THE COURT SHOULD PROVIDE A "BRIGHT LINE" CONSTITUTIONAL TEST FOR RETROACTIVE FEDERAL TAXATION: RETROACTIVE APPLICATION OF A FEDERAL TAX LAW IS *PER SE* UNCONSTITUTIONAL AS TO COMPLETED TRANSACTIONS AND OTHERWISE PRESUMPTIVELY UNCONSTITUTIONAL UNLESS NECESSARY TO ACHIEVE A COMPELLING LEGISLATIVE PURPOSE

Although the Ninth Circuit based its retroactivity decision on the due process clause of the Fifth Amendment, that holding necessarily implicates other textual and structural provisions of the Constitution dealing with retroactivity, foremost of which are the two *ex post facto* clauses.[6] *Amici* urge the Court to look closely at the federal *ex post facto* clause, as well as other constitutional indicia, not only for their own respective merits, but for insight into the meaning of the due process clause upon which the Ninth Circuit's decision rests. *See generally* Amar, *The Bill of Rights as a Constitution*, 100 Yale L.J. 1131, 1201 (1991) ("How could we forget that our Constitution is a *single* document, and not a jumble of disconnected clauses -- that it is *a* Constitution we are expounding." (Emphasis in original)).

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[6] U.S. Const. art. I, § 9 (Congress) & art. I, § 10 (states).

A. Unlike the State Legislative Power at Issue in *Calder v. Bull*, Congress' Powers Are Limited to Those Enumerated in the U.S. Constitution

It is still axiomatic in the late Twentieth Century that "[t]he Constitution created a Federal Government of limited powers." *New York v. United States*, ___ U.S. at ___, 112 S. Ct. at 2417 (citation omitted). Nevertheless, whether and to what extent Congress has the power to enact retroactive civil laws today does not lend itself to clean constitutional analysis, due to the seminal retroactivity case of *Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798).

In *Calder v. Bull*, the Court is generally understood to have held that the Constitution's two express prohibitions against *ex post facto* laws only apply to criminal legislation. A close reading of Justice Iredell's and Justice Peterson's separate concurring opinions in *Calder v. Bull*, however, suggests that the holding of the Court would have been different had the legislative power at issue been federal instead of state, as explained more fully below. This case presents a clean opportunity for the Court to revisit or distinguish *Calder v. Bull*, and to clarify the constitutional limits on Congress to enact tax legislation retroactively.

Calder v. Bull involved state legislation that "set aside a decree of the court of Probate for Hartford . . . and granted a new hearing." 3 U.S. (3 Dall.) at 386 (Chase, J.). As was the custom at the time, the Supreme Court delivered the opinions of the various justices *seriatim*. Justice Chase opined that the *ex post facto* prohibition applicable to the Connecticut legislature applied only to four types of criminal laws. 3 U.S. (3 Dall.) at 390. Justices Paterson and Iredell, in separate concurring opinions, expounded on the "indefinite nature" of the Connecticut Legislature's powers, which at the time included both legislative *and judicial* functions (in stark contrast to the federal Legislature's powers then and now).

The Court's decision in *Calder v. Bull* is thus not controlling precedent in a case involving the federal legislature, which unlike the legislative power at issue in *Calder v. Bull*, is constrained not only by explicit due process and *ex post facto* restrictions, but also by other organic, structural, and textual constitutional constraints on the exercise of federal legislative power. Accordingly, this case should be treated as both a due process case and a case of first impression under the federal *ex post facto* clause, as construed together with the other indicia of the intent of the framers and ratifiers of the United States Constitution vis-à-vis retroactive federal taxation.

B. The Constitution Restricts the Power of the Federal Government to Enact Retroactive Legislation of the Type in this Case

1. Textual indicia

a. Due process clauses

The Fifth Amendment provides that "[n]o person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V; *cf.* U.S. Const. amend XIV ("No state shall . . . deprive any person of life, liberty, or property, without due process of law."). The Solicitor General concedes that the "guaranty of due process" protects individuals from "unreasonable, arbitrary or capricious" governmental regulation of commercial matters. United States Brief at 12, *quoting Nebbia v. New York*, 291 U.S. 502, 525 (1934). *Amici* believe that retroactive taxation is antithetical to the rule of law and therefore *per se* "unreasonable, arbitrary or capricious" as a matter of procedural due process. As Justice Powell emphasized in *Mathews v. Eldridge*, 424 U.S. 319 (1976), "[t]he essence of due process is the requirement that 'a person in jeopardy of serious loss [be given] notice of the case against him and opportunity to meet it.'" 424 U.S. at 348 (quoting *Joint Anti-Fascist Comm. v. McGrath*, 341 U.S.

123, 171-72 (1951) (Frankfurter, J., concurring)). Retroactive legislation provides neither notice nor an opportunity "to meet it."

Amici dispute the Solicitor General's characterization of the Ninth Circuit's holding as concocting a new economic strain of *substantive* due process.[7] The Ninth Circuit's opinion focused on *procedural* not substantive issues, foremost of which is notice. *Carlton*, 972 F.2d at 1059 (first of two "paramount" circumstances is whether the taxpayer had "actual or constructive notice that the tax statute would be retroactively amended"); *see United States v. Hemme*, 476 U.S. at 569 ("One of the relevant circumstances is whether, without notice, a statute gives a different and more oppressive legal effect to conduct undertaken before enactment of the statute."); *see generally McNabb v. United States*, 318 U.S. 332, 347 ("The history of liberty has largely been the history of observance of procedural safeguards."), *reh'g denied*, 319 U.S. 784 (1943).

The procedural nature of constraints on retroactive lawmaking, whether criminal or civil, is made clear by Blackstone's famous exposition on "The Nature of Laws in General," wherein he discusses the several properties of "municipal or civil law," as distinguished from "the law of nature, the revealed law, and the law of nations":

> [Municipal or civil law] is likewise "a rule *prescribed*." Because a bare resolution, confined in the breast of the legislator, without manifesting itself by some external sign, can never be properly a law. It is requisite that this resolution

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[7] The Solicitor General begins both the "Reasons for Granting Petition" section of the United States' Petition for Certiorari and the "Argument" section of the merits brief with the following sentence: "The decision of the court of appeals adopts and applies a novel and erroneous three-step substantive due process test for determining the constitutionality of retroactive tax legislation." United States Cert. Petition at 10; United States Brief at 12.

> be notified to the people who are to obey it. But the manner in which this notification is to be made, is matter of very great indifference. . . . Yet, whatever way is made use of, it is incumbent on the promulgators to do it in the most public and perspicuous manner; not like Caligula, who (according to Dio Cassius) wrote his laws in a very small character, and hung them up upon high pillars, the more effectively to ensnare the people. There is still a more unreasonable method than this, which is called making of laws *ex post facto*; when *after* an action is committed, the legislator then for the first time declares it to have been a crime, and inflicts a punishment upon the person who has committed it; here it is impossible that the party could foresee that an action, innocent when it was done, should be afterwards converted to guilt by a subsequent law; he had therefore no cause to abstain from it; and all punishment for not abstaining must of consequence be cruel and unjust. All laws should be therefore made to commence *in futuro*, and be notified before their commencement; which is implied in the term "*prescribed.*"

W. Blackstone, 1 *Commentaries on the Laws of England* 45-46 (1765) (emphasis in original).[8]

Because this case presents a *procedural* conflict between individual rights and expectations on the one hand

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[8] *See Dash v. Van Kleeck*, 7 Johns. 477, 495 (N.Y. Sup. Ct. 1811) (Thompson, J.) ("After referring to the unjust and iniquitous practice of the *Roman* emperor, (*Caligula*), as to the manner of writing and publishing his laws, [Blackstone] observes, that there is still a *more unreasonable* method than this, which is called making laws *ex post facto*. Although, technically speaking, the term *ex post facto* may be applicable only to laws punishing criminal offenses, the principle is equally applicable to civil cases." (Emphasis in original)); *see generally Reno v. Flores*, ___ U.S. ___, ___, 113 S. Ct. 1439, 1455 (1993) (O'Connor, J., concurring) ("procedural due process protections" include "notice of charges").

and the federal government's desire to raise more revenues on the other, it fits squarely within the "principal function of the Due Process Clause." *McGautha v. California*, 402 U.S. 183, 254 (1971) (Brennan, J., dissenting, joined by Douglas and Marshall, JJ.) ("The principal function of the Due Process Clause is to ensure that state power is exercised only pursuant to procedures adequate to vindicate individual rights."), *vacated sub nom. Crampton v. Ohio*, 408 U.S. 941 (1972). If ever there was a fundamental civil right, albeit procedural, that is both "deeply rooted in this Nation's history and tradition," *Moore v. East Cleveland*, 431 U.S. 494, 503 (1977) (Powell, J.), and "implicit in the concept of ordered liberty," *Palko v. Connecticut*, 302 U.S. 319, 325, 326 (1937), it is the right to be free from retroactive governmental deprivations of personal property, such as the retroactive taxation imposed upon Carlton first by the IRS and then sanctioned by the Congress.

In explaining its due process holding, the Ninth Circuit emphasized that "[f]ederal courts have long been hostile to legislation that interferes with settled expectations." 972 F.2d at 1057 (citation omitted). This historic hostility towards "legislation that interferes with settled expectations" -- a common thread between due process and *ex post facto* restrictions on governmental power -- is not restricted to federal courts, but is prevalent as well among the historic writings that most influenced the framers and ratifiers of the United States Constitution.

As retroactivity in tax legislation eviscerates all other procedural protections, *amici* urge the Court to adopt a bright-line test that will prevent retroactive application of any federal tax law to completed transactions and will otherwise safeguard individual rights by creating a presumption of unconstitutionality unless the retroactive application of a new tax law is necessary for the achievement of a compelling legislative purpose independent of the desire to raise additional revenues.

b. *Ex post facto* clauses

Article I, section 9 of the U.S. Constitution, concerning restraints on Congress, states that "[n]o Bill of Attainder or *ex post facto* Law shall be passed." In a similar manner, article I, section 10 states that "[n]o State shall . . . pass any Bill of Attainder, *ex post facto* Law, or Law impairing the Obligation of Contracts." Practically all of this Court's caselaw examining and construing the term "*ex post facto*" involves the latter, and not the former. *See Collins v. Youngblood*, ___ U.S. ___, ___, 110 S. Ct. 2715, 2718-20 (1990) (Rehnquist, C.J., reviewing the litany of cases since *Calder v. Bull* that have restricted the term "to penal statutes which disadvantage the offender affected by them"). The Court's few cases involving the federal *ex post facto* prohibition typically cite *Calder v. Bull* (construing the state *ex post facto* prohibition) or other authorities stemming therefrom.[9]

The Court apparently has never before been faced with a federal *ex post facto* case that hearkened back to the distinguishing factors expounded by Justices Iredell and Paterson in *Calder v. Bull*, mentioned *supra* and discussed more fully *infra*. The Court's caselaw, however, has never fully closed the door on the obvious distinctions between federal and state *ex post facto* restrictions. For instance, Chief Justice Rehnquist's opinion in *Collins* suggests, at least implicitly, that the restrictive interpretation stemming from *Calder v. Bull* is limited to the state *ex post facto* clause. *See* ___ U.S. at ___, 110 S. Ct. at 2719 n.2 ("the Court has consistently adhered to the view expressed by Justices Chase, Paterson, and Iredell in *Calder* that the *Ex Post Facto* Clause applies only to penal statutes.").

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[9] *See, e.g., Kaiser Aluminum & Chemical Co. v. Bonjorno*, 494 U.S. 827, 855-56 (1990) (Scalia, J., concurring); *Harisiades v. Shaughnessy*, 342 U.S. 580, 594-95 (Jackson, J.), *reh'g denied*, 343 U.S. 936 (1952); *Mahler v. Eby*, 264 U.S. 32, 39 (1924) (Taft, C.J.); *Johannessen v. United States*, 225 U.S. 227, 242 (1912) (Pitney, J.).

In any case, while the contexts of the respective *ex post facto* prohibitions are quite distinguishable (see discussion of structural indicia, *infra*), they both evince a firm belief that retroactivity -- which results in the unsettling of established rights and/or expectations -- is inherently pernicious. Confirming this belief, James Madison wrote that "*ex-post-facto* laws, and laws impairing the obligation of contracts are contrary to the first principles of the social compact, and to every principle of sound legislation." *The Federalist* No. 44, at 128 (R. Fairfield 2d ed. 1966). The Congressional Research Service recognizes the historical legitimacy of arguments that the *ex post facto* clauses should apply to all legislation: "At the time the Constitution was adopted, many persons understood the terms *ex post facto* laws to 'embrace all retrospective laws, or laws governing or controlling past transactions, whether . . . of a civil or a criminal nature.'" Congressional Research Service, *The Constitution of the United States: Analysis and Interpretation*, S. Doc. No. 16, 99th Cong., 1st. Sess. 381-82 (1987) (quoting 3 J. Story, *Commentaries on the Constitution of the United States* § 1339 (Boston: 1833)).

Supporting the then-popular sentiment that retroactive criminal and civil laws were seen in the same light, the New Hampshire Constitution of 1784 warns that "[r]etroactive laws are highly injurious, oppressive, and unjust. No such law, therefore, should be made, either for the decision of civil causes, or the punishment of offenses." N.H. Const. of 1784, Part 1, § 23.

It is clear from the writings of Thomas Jefferson that the framers' abhorrence of *ex post facto* laws applied to all federal laws, whether civil or criminal. In 1813, for example (even after *Calder v. Bull*), Jefferson wrote of the retroactive application of a congressional patent law:

> Every man should be protected in his lawful acts, and be certain that no *ex post facto* law shall punish or endamage him for them. . . . The

> sentiment that *ex post facto* laws are against natural right, is so strong in the United States, that few, if any, of the State constitutions have failed to proscribe them. . . . [T]hey are equally unjust in civil as in criminal cases, and the omission of a caution which would have been right, does not justify the doing of what is wrong.

T. Jefferson, Letter to Isaac McPherson, Aug. 13, 1813, in 8 *The Writings of Thomas Jefferson* 326-27 (A. Bergh ed. 1903).

Likewise, Chancellor Kent of New York, while acknowledging the holding in *Calder v. Bull*, wrote that "there is no distinction in principle, nor any recognized in practice, between a law punishing a person criminally, for a past innocent act, or punishing him civilly by divesting him of a lawfully acquired right. The distinction consists only in the degree of the oppression, and history teaches us that the government which can deliberately violate the one right soon ceases to regard the other." *Dash v. Van Kleeck*, 7 Johns. 477, 506 (N.Y. Sup. Ct. 1811); *see* 7 Johns. at 503-04 (referring to intentionally retroactive laws as "pernicious" and "repugnant to common justice").

Notwithstanding *Calder v. Bull* and its legal progeny, a number of prominent jurists and scholars in this Century have insisted that the *ex post facto* clauses should apply in the civil context. *See, e.g.*, *Lehmann v. United States ex rel. Carson*, 353 U.S. 685, 690 (Black and Douglas, JJ., concurring in the result), *reh'g denied*, 354 U.S. 944 (1957); *Marcello v. Bonds*, 349 U.S. 302, 319 (Douglas, J., dissenting), *reh'g denied*, 350 U.S. 856 (1955); *see generally* Crosskey, *The True Meaning of the Constitutional Prohibition of Ex-Post-Facto Laws*, 14 Chi. L. Rev. 539 (1947) (citing original historical sources).

In a few cases since *Calder v. Bull*, the Court has even suggested that certain new civil laws, if applied retroactively, could be *per se* unconstitutional. For example, in *Herrick v. Boquillas Land & Cattle Co.*, 200

U.S. 96 (1906), this Court affirmed the Arizona Supreme Court's analysis that "if construed as absolutely barring causes of action existing at the time of its passage [a new statue of limitation] was unconstitutional." 200 U.S. at 102 (agreeing with Arizona Supreme Court -- citing *Sohn v. Watersohn*, 84 U.S. (17 Wall.) 596 (1873)). In 1927 this Court struck down a retroactive application of a federal estate tax as unconstitutional. *Nichols v. Coolidge*, 274 U.S. 531 (1927). Other cases have held that retroactively-imposed tax laws can be "confiscation of property in violation of due process of law." Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 20 Minn. L. Rev. 775, 796 (1936) (reviewing other cases; citations omitted).

Amici believe that retroactive taxation, especially as applied to completed transactions, is inherently unreasonable. More importantly, the *due process and ex post facto* clauses, together with contemporaneous historical indicia, demonstrate that the framers and ratifiers of the United States Constitution shared this belief.

2. *Structural indicia*

a. Retroactive tax laws violate the rule of law underpinnings of the Constitution.

Earlier this Century, the classical liberal scholar Friedrich von Hayek described the Rule of Law, with its inherent restriction on retroactive legislation, as the singlemost distinguishing factor of a free society: "Rule of Law . . . means that the government in all its actions is bound by rules fixed and announced beforehand -- rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one's individual affairs on the basis of this knowledge." F. von Hayek, *The Road to Serfdom* 72 (1944).

That a general prohibition against retroactive lawmaking is deeply rooted in Anglo/American jurisprudence cannot be disputed. Blackstone argued that "laws should not be enforced before the subjects have an opportunity to become acquainted with them." Smead, *supra*, at 777. James Madison justified restrictions on retroactive laws in the United States Constitution on the grounds that such restrictions "will banish speculations on public measures, inspire a general prudence and industry, and give a regular course to the business of society." *The Federalist* No. 44, at 128-29 (R. Fairfield 2d ed. 1966).

Other contemporaneous legal authorities who influenced the framers and ratifiers of the United States Constitution agreed generally that the type of retroactivity in this case is inherently contrary to the rule of law. For example, Professor Burlamaqui wrote: "It is necessary that the laws be sufficiently notified to the subject; for how could he regulate his actions and motions by those laws, if he had never any knowledge of them?" J. Burlamaqui, *The Principles of Natural Law* 104 (Nugent trans. 3d ed. 1780); *see* J. Burlamaqui, 2 *The Principles of Natural and Politic Law* 154 (Nugent trans. 3d ed. 1784) ("The establishment of civil society ought to be fixed, so as to make a sure and undoubted provision for the happiness and tranquillity of man. For this purpose it was necessary to establish a constant order, and this could only be done by fixed and determinate laws.").

More specifically to the facts of this case, the inherent injustice of a retroactive estate tax law is highlighted by the following example in Baron von Pufendorf's Seventeenth Century treatise *On the Law of Nature and Nations*:

> [A]n accurate distinction should be drawn between the positive law itself, and that right the acquisition of which is occasioned by that law. The former may be annulled afterwards by the legislator, but the right still remains, which was acquired by virtue of that law, so long as it was

> in force. For it would be the height of injustice to abolish along with a law all of its former effects. If, for example, it should be the law of a state, that, *As the head of a house may have disposed of his property by testament, so let the right to it stand*, certainly a legislator will be able to limit this freedom of testament, and to ordain that hereafter all inheritances shall be returned intestate. But it would be unjust to take away all property received by inheritance from those who received legacies while the former law was still in force.

1 Pufendorf, Ch. 6, § 6 (emphasis in original; citations omitted).

Amici respectfully suggest that this and other historical insights into the injustice of retroactive estate taxes are instructive as to how the framers and ratifiers of the United States Constitution would have viewed the type of retroactive federal tax law at issue in this case.

b. As applied to past transactions, retroactive federal laws are judicial in nature, and therefore violate the separation of powers doctrine

In *Calder v. Bull*, Justice Iredell suggested that the Connecticut legislature's exercise of *judicial* power in the form of purely retroactive legislation was "strange," implying that the federal Congress, due to separation of powers principles, could not even countenance the idea:

> It may, indeed, appear strange to some of us, that in any form there should exist a power to grant, with respect to suits depending or adjudged, new rights of trial, new privileges of proceeding, not previously recognized and regulated by positive institutions; but such is the established usage of Connecticut, and it is obviously consistent with the general superintending authority of her

> Legislature. . . . The power, however, is judicial in its nature; and whenever it is exercised, as in the present instance, it is an exercise of judicial, not of legislative, authority.

3 U.S. (3 Dall.) at 398 (Iredell, J., concurring "in the general result," dissenting in part due to "the reasons that are assigned").

Chancellor Kent of New York, author of *Commentaries on American Law* (9th ed. 1858), while acknowledging the holding in *Calder v. Bull* in *Dash v. Van Kleeck*, *supra*, expounded on the judicial nature of retroactive legislation:

> It is equally inadmissible to consider [a legislative] act as declaring how the former statutes were to be *construed*, as to cases already existing. If this interpretation was to be considered as giving the former acts a new meaning, it then becomes a new rule, and is to have the same effect, as any other newly created statute. But if it be considered as an exposition of the former acts for the information and government of the courts in the decision of causes before them, it would then be taking cognisance of a judicial question. This could not *possibly* have been the meaning of the act, for the power that makes is not the power to construe a law. It is a well settled axiom that the union of these two powers is tyranny. . . . Our government . . . consists of departments, and contains a marked separation of the legislative and judicial powers. . . . [T]he right to interpret laws does, and ought to belong exclusively to the courts of justice.

7 Johns. at 508-09 (emphasis in original).

Professor Story later justified the result in *Calder v. Bull* on grounds clearly distinguishable from federal legislation: "There is nothing in the Constitution of the

United States which forbids a State legislature from exercising judicial functions; nor from divesting rights vested by law in an individual, provided its effect be not to impair the obligation of a contract." J. Story, 2 *Commentaries on the Constitution of the United States* 272 (5th ed. 1891).

Justice Scalia more recently opined that retroactivity, while appropriate for judicial decisions, is constitutionally problematic for legislation generally: "[I]t is said that that which distinguishes a judicial from a legislative act is, that the one is a determination of what the existing law is in relation to some existing thing already done or happened, while the other is a predetermination of what the law shall be for the regulation of all future cases." *Harper v. Virginia Dep't of Taxation*, __ U.S. __ , 61 U.S.L.W. 4664, 4669 (June 18, 1993) (Scalia, J., concurring) (quoting T. Cooley, *Constitutional Limitations* 91 (1868)).[10]

To the extent the 1987 amendment to the Tax Reform Act of 1986 is what the Committee Report purports, *i.e.*, a conforming amendment to bring the Tax Reform Act of 1986 in line with "the original intent of Congress." H.R.Rep. No. 100-391, 100th Cong., 1st Sess., Pt. II, at 1045 (1987), the 1987 amendment, as applied to this case, is judicial in nature and therefore contrary to the separation of powers doctrine.

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[10] *See* Aiken, *Ex Post Facto in the Civil Context: Unbridled Punishment*, 81 Ky. L.J. 323, 327-33 (1993) (discussing historical bases for *ex post facto* restrictions vis-à-vis separation of powers); *see generally* Laycock, *Due Process and Separation of Powers: The Effort to Make the Due Process Clauses Nonjusticiable*, 60 Tex. L. Rev. 875, 878 (1982) ("the due process clauses look to legislatures only for substantive entitlements, and . . . the clauses commit minimum procedural rights to the Constitution and therefore to the Court"), *citing* Michelman, *Formal and Associational Aims in Procedural Due Process*, in Nomos XVIII: Due Process 126, 133-34, 158-59 n.27 (J.R. Pennock and J. Chapman eds. 1977).

c. Federal legislative power does not extend between Congresses

Article 1, Section 1 vests all "legislative powers . . . in a Congress of the United States, which shall consist of a Senate and a House of Representatives." Every two years a new Congress is formed, and this Court has observed that the views of one Congress about the intent of a prior enacting Congress are entitled to little deference. *See United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 34 (1982); *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 354 n. 39 (1977); *see also United Airlines v. McMann*, 434 U.S. 192, 200 n.7 (1977) ("Legislative observations 10 years after the passage of the Act are in no sense part of the legislative history.").

In September of 1986 the 99th Congress enacted an estate tax deduction for sales of employer securities to ESOP's within the Tax Reform Act of 1986, after which it adjourned. More than a year later, the newly elected and substantially transformed 100th Congress enacted another law, labeled a "Congressional Clarification of Estate Tax Deduction for Sales of Employer Securities," which purported to conform the Tax Reform Act of 1986 to "the original intent of Congress." H.R.Rep. No. 100-391, 100th Cong., 1st Sess., Pt. II, at 1045 (quoted at *Carlton*, 972 F.2d at 1054-55). But one Congress cannot definitely speak for the intent of another, for such would be an usurpation of judicial power. *Cf. James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, ___, 111 S. Ct. 2439, 2450-51 (Scalia, J., joined by Marshall and Blackmun, JJ.) (discussing judicial retroactivity vis-à-vis the division of federal powers).

The limitation in Article 1, Section 1 of "all legislative power" to "a Congress" suggests that the legislative power does not extend between Congresses. Accordingly, once a Congress has adjourned, that Congress' intent cannot be reconsidered by a subsequent Congress, especially as to cases and controversies wherein individuals have relied upon a law enacted by the prior Congress. As Chief

Justice Marshall admonished in *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810), "if an act be done under a law, a succeeding legislature cannot undo it. The past cannot be recalled by the most absolute power." 10 U.S. (6 Cranch) at 135 (discussing contract clause restrictions on state governments).

Because Carlton's transaction was completed under section 2057, as enacted by the 99th Congress, the 1987 amendment by the 100th Congress "cannot undo it." *Id.*

d. The federal *ex post facto* clause should be construed broadly for a government of limited powers

To the extent a power to enact retroactive legislation turns on presumptions (such as the presumption that the founders intended the term "*ex post facto*" to apply only to criminal statutes), any such presumptions should take into consideration the fundamentally different natures of state versus federal governmental powers in the United States.[11] As the Court clarified in *Butler*:

> Each state has all governmental powers save such as the people, by their Constitution, have conferred upon the United States, denied to the

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[11] *See* T. Cooley, *Constitutional Limitations* 173 (1868) ("The government of the United States is one of *enumerated* powers; the governments of the States are possessed of all the general powers of legislation. When a law of Congress is assailed as void, we look in the national Constitution to see if the grant of specified powers is broad enough to embrace it; but when a State law is attacked on the same ground, it is presumably valid in any case, and this presumption is a conclusive one, unless in the Constitution of the United States or of the State we are able to discover that it is prohibited. . . . Congress can pass no laws but such as the Constitution authorizes either expressly or by clear implication; while the State legislature has jurisdiction of all subjects on which its legislation is not prohibited."). Accordingly, a state government may be presumed to have a power to enact retroactive civil laws while the federal government is presumed not to have such power.

> states, or reserved to themselves. The federal union is a government of delegated powers. It has only such as are expressly conferred upon it and such as are reasonably to be implied from those granted. In this respect we differ radically from nations where all legislative power, without restriction or limitation, is vested in a parliament or other legislative body subject to no restrictions except the discretion of its members.

297 U.S. at 63.

The power of Congress to tax *retroactively* is neither enumerated nor "reasonably to be implied from those granted." 297 U.S. at 63. As the Court concluded in *Butler*, "the only thing granted [in art. I, § 8, cl. 1] is the power to tax for the purpose of providing funds for payment of the nation's debts and making provision for the general welfare." 297 U.S. at 64; *see* 297 U.S. at 69-70 ("It would undoubtedly be an abuse of the [taxing] power . . . if exercised for ends inconsistent with the limited grants of power in the Constitution."), *quoting Veazie Bank v. Fenno*, 8 Wall. 533, 541 (1868). The Solicitor General would extend this limited power to include the power retroactively to amend "revenue laws to fairly allocate to taxpayers the burdens and benefits of national fiscal policies and to prevent evasion of those laws 'by the vigilant and ingenious.'" United States Brief at 15. Such an extension of non-enumerated power to Congress, to use the Solicitor General's own words (United States Brief at 19), "lacks a foundation" in either the text or the structure of the United States Constitution.

CONCLUSION

Amici urge the Court to affirm the Ninth Circuit's due process holding, and in so doing to provide a "bright line" constitutional test for retroactive federal tax legislation based on the constitutional guarantee of procedural due process, as well as on the other textual and structural indicia of intent by the framers and ratifiers of the

Constitution to protect individuals from a federal law that would tax, or increase net taxes on, past activities. The Constitution prohibits retroactive application of federal tax laws as to completed transactions and prohibits retroactive application generally unless necessary to achieve a compelling legislative purpose independent of the desire to raise additional revenues.

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Date: December 14, 1993

Commentaries on the Laws of England

William Blackstone

A Facsimile of the First Edition of 1765–1769

VOLUME I

Of the Rights of Persons

(1765)

With an Introduction by Stanley N. Katz

The University of Chicago Press
Chicago & London

IF man were to live in a ſtate of nature, unconnected with other individuals, there would be no occaſion for any other laws, than the law of nature, and the law of God. Neither could any other law poſſibly exiſt; for a law always ſuppoſes ſome ſuperior who is to make it; and in a ſtate of nature we are all equal, without any other ſuperior but him who is the author of our being. But man was formed for ſociety; and, as is demonſtrated by the writers on this ſubject[b], is neither capable of living alone, nor indeed has the courage to do it. However, as it is impoſſible for the whole race of mankind to be united in one great ſociety, they muſt neceſſarily divide into many; and form ſeparate ſtates, commonwealths, and nations; entirely independent of each other, and yet liable to a mutual intercourſe. Hence ariſes a third kind of law to regulate this mutual intercourſe, called "the law of "nations;" which, as none of theſe ſtates will acknowlege a ſuperiority in the other, cannot be dictated by either; but depends entirely upon the rules of natural law, or upon mutual compacts, treaties, leagues, and agreements between theſe ſeveral communities: in the conſtruction alſo of which compacts we have no other rule to reſort to, but the law of nature; being the only one to which both communities are equally ſubject: and therefore the civil law[c] very juſtly obſerves, that *quod naturalis ratio inter omnes homines conſtituit, vocatur jus gentium.*

THUS much I thought it neceſſary to premiſe concerning the law of nature, the revealed law, and the law of nations, before

[b] Puffendorf, *l.* 7. *c.* 1. compared with Barbeyrac's commentary. [c] *Ff.* 1. 1. 9.

I proceeded to treat more fully of the principal ſubject of this ſection, municipal or civil law; that is, the rule by which particular diſtricts, communities, or nations are governed; being thus defined by Juſtinian [d], "*jus civile eſt quod quiſque ſibi populus conſtituit.*" I call it *municipal* law, in compliance with common ſpeech; for, tho' ſtrictly that expreſſion denotes the particular cuſtoms of one ſingle *municipium* or free town, yet it may with ſufficient propriety be applied to any one ſtate or nation, which is governed by the ſame laws and cuſtoms.

MUNICIPAL law, thus underſtood, is properly defined to be "a rule of civil conduct preſcribed by the ſupreme power in "a ſtate, commanding what is right and prohibiting what is "wrong." Let us endeavour to explain it's ſeveral properties, as they ariſe out of this definition.

AND, firſt, it is a *rule*; not a tranſient ſudden order from a ſuperior to or concerning a particular perſon; but ſomething permanent, uniform, and univerſal. Therefore a particular act of the legiſlature to confiſcate the goods of Titius, or to attaint him of high treaſon, does not enter into the idea of a municipal law: for the operation of this act is ſpent upon Titius only, and has no relation to the community in general; it is rather a ſentence than a law. But an act to declare that the crime of which Titius is accuſed ſhall be deemed high treaſon; this has permanency, uniformity, and univerſality, and therefore is properly a *rule*. It is alſo called a *rule*, to diſtinguiſh it from *advice* or *counſel*, which we are at liberty to follow or not, as we ſee proper; and to judge upon the reaſonableneſs or unreaſonableneſs of the thing adviſed. Whereas our obedience to the *law* depends not upon *our approbation*, but upon the *maker's will*. Counſel is only matter of perſuaſion, law is matter of injunction; counſel acts only upon the willing, law upon the unwilling alſo.

[d] *Inſt.* 1. 2. 1.

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IT is alſo called a *rule*, to diſtinguiſh it from a *compact* or *agreement*; for a compact is a promiſe proceeding *from* us, law is a command directed *to* us. The language of a compact is, "I "will, or will not, do this;" that of a law is, "thou ſhalt, or "ſhalt not, do it." It is true there is an obligation which a compact carries with it, equal in point of conſcience to that of a law; but then the original of the obligation is different. In compacts, we ourſelves determine and promiſe what ſhall be done, before we are obliged to do it; in laws, we are obliged to act, without ourſelves determining or promiſing any thing at all. Upon theſe accounts law is defined to be "*a rule.*"

MUNICIPAL law is alſo "a rule *of civil conduct.*" This diſtinguiſhes municipal law from the natural, or revealed; the former of which is the rule of *moral* conduct, and the latter not only the rule of moral conduct, but alſo the rule of faith. Theſe regard man as a creature, and point out his duty to God, to himſelf, and to his neighbour, conſidered in the light of an individual. But municipal or civil law regards him alſo as a citizen, and bound to other duties towards his neighbour, than thoſe of mere nature and religion: duties, which he has engaged in by enjoying the benefits of the common union; and which amount to no more, than that he do contribute, on his part, to the ſubſiſtence and peace of the ſociety.

IT is likewiſe "a rule *preſcribed.*" Becauſe a bare reſolution, confined in the breaſt of the legiſlator, without manifeſting itſelf by ſome external ſign, can never be properly a law. It is requiſite that this reſolution be notified to the people who are to obey it. But the manner in which this notification is to be made, is matter of very great indifference. It may be notified by univerſal tradition and long practice, which ſuppoſes a previous publication, and is the caſe of the common law of England. It may be notified, *viva voce*, by officers appointed for that purpoſe, as is done with regard to proclamations, and ſuch acts of parliament

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as are appointed to be publicly read in churches and other aſſemblies. It may laſtly be notified by writing, printing, or the like; which is the general courſe taken with all our acts of parliament. Yet, whatever way is made uſe of, it is incumbent on the promulgators to do it in the moſt public and perſpicuous manner; not like Caligula, who (according to Dio Caſſius) wrote his laws in a very ſmall character, and hung them up upon high pillars, the more effectually to enſnare the people. There is ſtill a more unreaſonable method than this, which is called making of laws *ex poſt facto*; when *after* an action is committed, the legiſlator then for the firſt time declares it to have been a crime, and inflicts a puniſhment upon the perſon who has committed it; here it is impoſſible that the party could foreſee that an action, innocent when it was done, ſhould be afterwards converted to guilt by a ſubſequent law; he had therefore no cauſe to abſtain from it; and all puniſhment for not abſtaining muſt of conſequence be cruel and unjuſt[c]. All laws ſhould be therefore made to commence *in futuro*, and be notified before their commencement; which is implied in the term "*preſcribed*." But when this rule is in the uſual manner notified, or preſcribed, it is then the ſubject's buſineſs to be thoroughly acquainted therewith; for if ignorance, of what he *might* know, were admitted as a legitimate excuſe, the laws would be of no effect, but might always be eluded with impunity.

BUT farther: municipal law is "a rule of civil conduct pre-"ſcribed *by the ſupreme power in a ſtate*." For legiſlature, as was before obſerved, is the greateſt act of ſuperiority that can be exerciſed by one being over another. Wherefore it is requiſite to the very eſſence of a law, that it be made by the ſupreme power. Sovereignty and legiſlature are indeed convertible terms; one cannot ſubſiſt without the other.

[c] Such laws among the Romans were denominated *privilegia*, or private laws, of which Cicero *de leg.* 3. 19. and in his oration *pro domo*, 17. thus ſpeaks; "*Vetant leges* "*ſacratae, vetant duodecim tabulae, leges privatis hominibus irrogari; id enim eſt privi-*"*legium. Nemo unquam tulit, nihil eſt crudelius,* "*nihil pernicioſius, nihil quod minus haec civi-*"*tas ferre poſſit.*"

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The Economic Effects of Retroactive Taxation

Testimony Presented to the
Senate Government Affairs Committee

December 7, 1995

by Nancy L. Mitchell
Vice President for Policy Implementation
Citizens for a Sound Economy

Mr. Chairman, members of the Committee, my name is Nancy L. Mitchell. I serve as Vice President for Policy Implementation of Citizens for a Sound Economy, a 250,000-member public policy organization dedicated to promoting economic growth through market-based solutions to public policy problems. I appreciate having the opportunity to testify about the effects of retroactive tax policy.

My remarks will focus on the economic effects of retroactive taxation. I realize that there are important legal and moral arguments against the practice, but I will leave those issues to the lawyers and philosophers.

It has been stated that retroactive taxation poses few economic problems. According to conventional wisdom, the fact that a tax is imposed after the economic behavior in question has been undertaken presumably means there is no opportunity for the taxpayer's incentives to be diminished. As a result, all the usual ill effects of taxation -- particularly the impact of higher marginal tax

rates -- on incentives to work, save, and invest are avoided because taxpayers cannot go back in time to change their economic behavior.

This analysis is true, but incomplete. There is no question that lawmakers can levy a tax on last year's output and income with complete confidence that taxpayers will be unable to go back and reduce the amount of working, saving, and investing they did. Note, however, that this so-called "harmless" scenario relies on taxpayers being completely fooled by the imposition of retroactive taxes. Being "fooled" presupposes that taxpayers and the entire tax advice industry do not pay attention to what Congress does. While this may happen sometimes, in the age of C-SPAN and Rush Limbaugh, it is rare.

Taxpayers certainly were not fooled by the retroactivity of the Clinton tax increase in 1993. As chart one illustrates, there was a huge spike in personal income in late 1992 -- along with a corresponding drop in early 1993. Taxpayers all across the country, from corporate executives to future First Ladies to major league baseball players, took steps to accelerate income into the 1992 tax year because of the expectation that the incoming administration would impose a new, high tax on at least some portion of 1993 income.

Defenders of retroactive taxation, confronted by this marked shift in taxpayer behavior, might be tempted to claim that the retroactivity had no adverse consequences. Taxpayers, after all, still paid 1992 taxes on that income. What harm, therefore, was done to the government's finances (the finances of taxpayers, unfortunately, never seem to be a major concern)? Needless to say, if astute taxpayers were sufficiently aware of the threat of higher taxes that they engaged in massive income-shifting, then it certainly stands to reason that they also were aware enough to reduce the levels of work, saving, and investment in which they engaged.

And indeed, that is precisely what began to happen. As you can see from chart two, well-to-do taxpayers began shifting money into shelters such as municipal bonds and took other steps to protect their income from the government. To be sure, the impact of reduced incentives becomes more pronounced over time (see the attached chart showing how "rich" taxpayers responded to the tax increase between 1992 - 1993; the amount of income reported by those earning more than $500,000 fell by -3.5 percent while earnings from all other income classes rose 2.7 percent). Nonetheless, this is evidence that retroactive taxes can have harmful economic effects.

Perhaps the worst economic aspect of retroactive taxes, however, is their impact on savings. Regardless of whether taxpayers know ahead of time that a retroactive tax is coming, the actual tax liability is almost certainly paid for with savings. Considering that the only economic rationale that has ever been offered for higher taxes is that they will boost the amount of savings available for private investment, even the most ardent tax-increaser, one must assume, should recognize that a tax increase financed out of savings will have no positive effect. And for those in the real world who understand the strong historical relationship between higher taxes and more spending -- as well as the adverse impact on economic growth -- this makes retroactive taxation a very self-defeating policy.

In the overall context of tax policy, the fact that the 1993 increase in tax rates was retroactive is a relatively minor economic problem when compared to the ongoing damage high tax rates are imposing on the economy. Nonetheless, the damage that is imposed, particularly when the moral component is taken into consideration, should convince lawmakers never to travel down this path again.

The best solution would be for policy makers to adopt a flat tax. This type of system, which taxes all income only once and at one low rate, would do

much to restore faith in the political system. The various deductions, exemptions, and discrepancies in the current code would be removed, and with them, the political playing field for lobbyists and special interests. The low rate would spur economic growth and increase compliance. The super majority provisions in the Armey-Shelby bill would also provide taxpayers with much needed certainty. This is particularly worthwhile in light of the fact that the current system is significantly changed every 1.3 years. Thank you, and I will be happy to answer any questions.

CHART ONE

Month-to-Month Changes in Seasonally Adjusted Personal Income

(source: *Survey of Current Business*, 10/93 & 1/94)

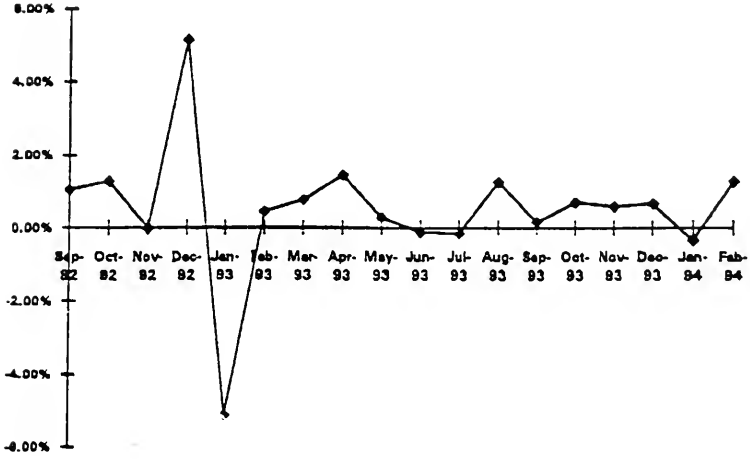
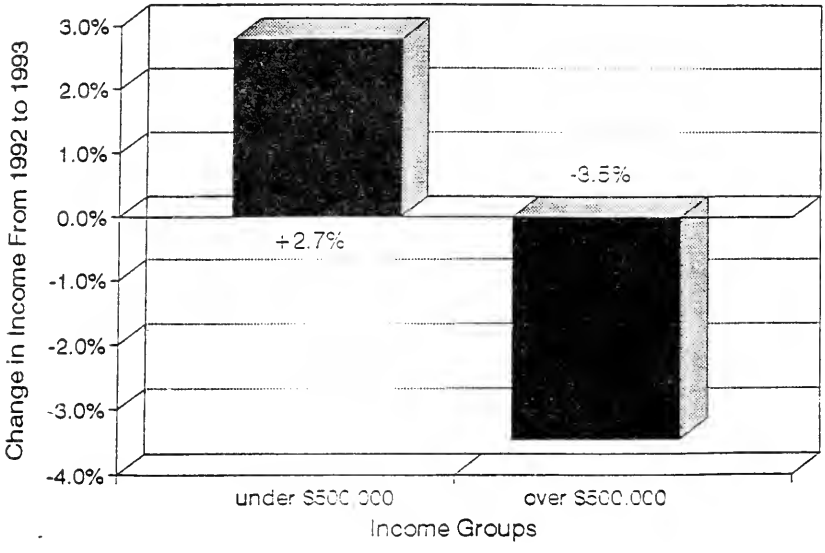


CHART TWO

IN 1993, ONLY THOSE EARNING OVER $500,000 SAW THEIR TAXABLE INCOME FALL



PREPARED STATEMENT OF PETER FERRARA

Mr. Chairmen, thank you for the invitation to appear before this committee to discuss the issue of retroactive tax increases. These hearings provide an excellent opportunity to initiate an informed debate on this significant tax problem. In the face of the American government's appetite for revenue we need to enact a mechanism to prevent Congress from relying on retroactive taxes.

Throughout the history of the United States there have been several instances where the United States Congress has passed tax laws with retroactive effect. None have been more costly or egregious than those enacted in 1993 by the 103rd Congress at the direction of the Clinton Administration. Until recently, retroactive laws have been limited and have been upheld by the United States Supreme Court on narrow grounds. Recently, however, the Supreme Court has thrown out years of precedent and held that retroactive tax increases are constitutionally permissible.

It is the position of the Americans for Tax Reform that the position of the Supreme Court is wrong and that retroactive tax laws are indeed unconstitutional. Further, these laws are an immoral attempt by a far too large government bent on raising revenue from whatever source possible regardless of any economic or social cost borne by the taxpayers. Additionally, retroactive tax laws make bad economic policy and might ultimately lead to a slowdown in economic growth and employment. The only way to stop any further application of this "bait-and-switch" revenue raiser is to enact S. 94 and its prohibition on retroactive taxation.

I. Retroactive Tax Increases Are Unconstitutional

Even in Russia retroactive taxes are unconstitutional. Unfortunately, our highest court finds them well within the bounds of the United States Constitution. Recently in *United States* v. *Carlton* [1] the Supreme Court attempted to justify the use of retroactive taxes. In its opinion the Court stated that provided a retroactive tax is supported by a legitimate legislative purpose all judgments about such a tax are exclusively for the legislative and executive branches. They further stated that the burden of these governmental branches is met simply by showing that the retroactive tax is justified by a rational legislative purpose. The Court reduced over 50 years of prior precedent by stating that previous cases which held retroactive taxes unconstitutional were decided in "an era characterized by exacting review of economic legislation under an approach that has "long been discarded.'" [2]

In deciding that retroactive taxes are constitutional the Supreme Court neglected any discussion of the fact that retroactive taxes are unconstitutional *ex post facto* laws. An *ex post facto* law is one which is passed after the occurrence of an act which retrospectively changes the legal consequences or relations of the act. A law is unconstitutionally *ex post facto* if it deprives a defendant of defenses to criminal liability that he had prior to enactment of the retroactive law. The United States Supreme Court has ruled that retroactive tax increases which subject a taxpayer to potential criminal liability are unconstitutional.[3]

Retroactive tax increases have substantial *ex post facto* effect. By mandating that a taxpayer is liable for the payment of additional taxes over the amount he had already paid they expose any taxpayer refusing to pay his additional tax to criminal prosecution for tax evasion. These laws deprive the taxpayer of the defense that he has in fact paid his tax by requiring that he pay additional sums in order to not violate the new law.

Clearly, this violates the constitution. It leaves the taxpayer to the mercy of an executive and legislative branch that for whatever "legitimate" reason decides to increase his taxes retroactively. Consequently, taxpayers in effect will never know when they may be charged with a criminal violation even though they have satisfied that tax regulations to the letter of the law. In effect, the government is holding the innocent taxpayers' liberty interest hostage to his ability and willingness to pay additional tax.

II. Retroactive Taxes are Immoral and Unfair

Retroactively increasing the amount of taxes owed is fundamentally an immoral government intrusion into the lives of hard working Americans. Americans who make everyday budgetary decisions based upon how much they expect to pay the federal government. Americans who makes plans for their estates based upon the knowledge that their heirs will be able to enjoy the fruits of their success. Americans who voted overwhelmingly in November 1994 for lower taxes and less government intrusion into their lives.

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[1] 114 S. Ct. 2018 (1994).
[2] *Id.* at 2024.
[3] *Burges* v. *Salmon,* 1878.

Setting the tax rate at one level and then later changing it to increase the tax burden is patently unfair. To ensure fairness in the context of a retroactive tax the question to ask is: are the taxpayers, on the date of the proposed application, in some way on notice or aware that such a change in the tax law could or would be made? If they are then fairness would be achieved. In the absence of such knowledge any retroactive tax is unfair.

The 1993 retroactive tax increase imposed by Clinton is a prime example of this unfairness. The American taxpayers conducted their economic transactions in 1993 with no knowledge that such a retroactive tax increase was pending. A quick look at the events that transpired in 1992 and 1993 clearly illustrate this point. During his campaign Clinton offered a middle-class tax cut. Although he said he would raise some taxes on those making over $250,000.00, Clinton did not release any details of his increases until late February, 1993. When he finally did disclose the true extent of his tax increase those with incomes as low as $115,000.00 were subject to increased taxes retroactive to January 1, 1994, almost a month before Clinton became President!

In effect, Bill Clinton found a way to increase the term of his presidency. A way which will be ratified by this Congress if you fail to adopt legislation banning retroactive tax increases.

III. Retroactive Tax Laws Introduce Uncertainty Into the Economy

Even if a retroactive tax is constitutional, it is unsound economic policy. One of the hallmarks of the American economy, or any successful economy, is that all those involved in transactions, whether sophisticated merchants or the average family purchasing goods and services, enjoy certainty and stability in their economic affairs. This is embedded in the United States Constitution. We know that government will not expropriate our investments and property without paying adequate, just and prompt compensation. We know that governments will not unwind our economic lives. Without this certainty and stability both businesses and private citizens would suffer an intolerable chill over their economic affairs.

One of the goals of government economic policy should be to provide a positive environment for economic activities. Certainty and stability are necessary to foster that environment. This does not mean that government must provide taxpayers with a guarantee that tax rates will not be changed in future years. Instead, individuals require certainty that transactions already entered into, with settled expectations, will not be subject to tax changes unknown at the time of the transaction.

Allowing Congress to pass retroactive taxes will shackle all future economic activity with a "tax risk premium" Long-term planning will be discouraged due to a risk that Congress will retroactively change the rules of the game. Those putting their money to work in our economy for positive purposes will require a higher rate of return as compensation for the tax risk premium. The implication of this is less investment in our economy as investors find other locales in which to invest their funds. Plans for new factories, equipment purchases, and business start-ups will be delayed and in some cases abandoned. This translates directly into lower levels of economic growth and fewer jobs for Americans.

It is worth noting that in less developed nations investors typically require higher rates of return to compensate for their increased risk. Consequently, they suffer from very low rates of capital investment. A retroactive tax increase without notice is nothing more than a partial government taking of private property. A confiscatory practice that one might expect from a poor third world nation, not the United States.

V. Conclusion

Congress must enact legislation banning all retroactive tax increases. Doing so will end a distressing trend of judicial acquiescence to overreaching tax legislation. It will put a stop to the continued immoral and unfair practice of retroactively increasing an already punishing tax burden. A burden which is robbing from our children to pay for the United States profligate government spending. Finally, it will solidify the certainty and stability of the United States economy in the eyes of investors around the world.

PREPARED STATEMENT OF WAYNE NELSON

Chairman Stevens, and members of the committee. Thank you for asking me to testify today about this important legislation. My name is Wayne Nelson. I am President of Communicating for Agriculture, a membership organization representing farmers, ranchers and rural business people in all 50 states including your state of Alaska.

S. 94 would amend the Congressional Budget Act of 1974 to prohibit Congress from considering retroactive tax increases. Communicating for Agriculture strongly supports this legislation because of basic fairness, and because it should always be a basic right for citizens and businesses to be informed about tax policies and be able to plan ahead. Tax planning is fundamental to financial management for any business and family today. Retroactive tax increases inherently violates the ability of the public to have fair and prudent financial management regarding taxes.

My own situation illustrates the unfairness and difficulties that can impact people when retroactive taxes are enacted—whether or not policy makers intended them to have that impact.

I am a farmer from Winner, South Dakota. I farmed with my father until his death in 1993. We raise wheat, sunflowers, corn and grain sorghum on a dryland farm. I own some land by myself, but much of the land I farmed was owned by my father.

My father died in May of 1993. In the fall of 1993, a large budget bill was passed by Congress. This legislation contained several retroactive tax measures. A 5 percent increase in income tax rates for estates was one of these retroactive tax measures. It was passed in the fall of 1993, after my father's death, but had a retroactive starting date a few weeks before my father's death. This additional five percent cost my family's estate several thousand dollars and seemed as though it was adding insult to injury because it was applied retroactively.

Additionally, the estate is now being audited and it appears the extra five percent could amount to more than $10,000.

The estate had to pay a significant amount of South Dakota State inheritance tax, as well as Federal estate taxes. To pay these taxes, more than 700 acres of land had to be sold. I was lucky that I could continue to farm. Many farms and small businesses that have to be sold to pay estate taxes, aren't so lucky.

This puts added strain on rural areas by the loss of businesses. Estate taxes are very unfair for farmers and small businesses. One generation builds up assets, paying income tax along the way and wants to pass the business to the next generation. When the estate is settled, many times the next generation has to sell the business to pay the tax.

Retroactive tax increases are bad for everyone. My personal experience had been that retroactive tax increases affect me even after my father's death.

Thank you very much for the opportunity to testify. I would be glad to try to answer questions at the appropriate time.

PREPARED STATEMENT OF ROBERT J. PROCTOR

Mr. Chairman and other members of the committee and Senator Coverdell, I wish to thank you for the opportunity to speak to you today on Senate Bill 94.

My name is Robert J. Proctor and I reside in Atlanta, Georgia. I am chairman of the Board of Trustees of the Southeastern Legal Foundation, a public interest law firm which promotes individual freedom, limited government and capitalism. Southeastern Legal Foundation was founded in 1976, is headquartered in Atlanta, Georgia, and represents individuals, businesses and groups in litigation throughout the southeastern United States. I am also a practicing attorney and managing partner of my law firm, Proctor, Felton & Atkinson, In Atlanta, Georgia.

In appearing before you today, I am speaking for myself, and not for the Foundation, as our charter prohibits us from taking positions on legislation.

In 1789, Benjamin Franklin wrote that nothing in this world is certain but death and taxes. He, of course, was wrong. Even taxes can be uncertain, which is the problem we are here to address today.

I have represented taxpayers in the state of Georgia in numerous class action and other public interest suits in the taxation area in the past several years against the state of Georgia and various local governments located therein. I regret to say that I have not yet had the opportunity to represent taxpayers against the federal government with regard to federal taxation issues, but many of the concerns which are sought to be addressed by Senate Bill 94 arise in the state and local taxation field as well. Even on the day that I prepared my written remarks for today, my office was working on problems in property taxes in the City of Atlanta, where the tax assessors have fallen far behind in keeping up with the assessment of newly constructed buildings, and just now are sending out reassessments going back to 1992 and 1993. In many of these cases, the property had already been sold before the reassessment arrived, but our laws put the lien on the new owner as well Just last week, our appeals court held these "retroactive reassessments" were illegal.

Coming from a background of litigation and a life spent in law, it is tempting to direct my remarks to the development of the law of retroactive taxation as it has evolved in the Federal courts of this country. I believe, however, that the Committee is probably well acquainted with this line of case authority, and I am cognizant of my position in the order of witnesses appearing before this Committee today. More fundamentally, however, it is my belief that simply because the courts allow the Congress to take certain actions does not mean those actions, when taken by this Congress, are right, or are equitable, or are just, or are fair. And, as we say where I come from, retroactive taxation just ain't fair.

While Senate Bill 94 is worded generally, as well it should be, to include all types of retroactive taxation, it is proposed and will be understood by most Americans, if it passes, to apply with particular significance to income taxation. For it is income taxation by which this government derives the vast bulk of its revenues, and it is income taxation which most directly affects most Americans.

Whether the American is a wage earner who has his income taxes deducted from his paycheck by his employer, like the secretaries in my law office, or the retiree who pays quarterly estimated taxes, like my mother, or the independent, small businessman, like myself, who struggles to accurately estimate his tax liability when the income is far from certain, planning for, saving for, and paying income taxes occupies a great portion of the lives of ordinary Americans. And, when the rules of the game are changed after the game has already been played, great inequities and injustices result.

This Committee, and this Congress, should bear in mind that the average American now spends about a third of his or her year, and about a third of his or her income, to pay income taxes to Federal, State and local governments. And, it is important to include in the analysis state and local taxation, as so many of our states and local governments borrow from the Federal taxation schemes in establishing their own taxation schemes. Whenever a third of your life is affected, one tends to plan around it. And it is certainly true that Americans plan their spending, their saving, their investments, and their transactions in light of the tax consequences that flow from those. It is bad enough when the rules are so complex that you have to hire professionals to interpret them. It is bad enough when the rules change dramatically virtually every year. It is intolerable, however, for the rules to change after plans have already been made.

In addition, Senate Bill 95 will promote responsibility in this Congress in limiting the opportunity to meet revenue needs by singling out certain classes of taxpayers for retroactive taxation, instead of spreading present revenue needs over the wide base of present tax sources. For an example of this, we need but look at the case of *Welch* v. *Henry*, which was decided in the United States Supreme Court in 1938. In that case, the Wisconsin legislature, in order to meet what they perceived as "emergency" revenue needs for unemployment payments in 1935, imposed a tax on dividends which had previously been exempt. But, they did not limit the tax to dividends paid after the bill was passed, or even dividends in 1935: they went all the way back to 1933. The taxpayer in question's sole taxable income was from these kinds of dividends. He dutifully filed a return in 1933, but owed no taxes. Then, two years later, he was presented with a bill for his share of the budget needs of Wisconsin in 1935. As in so many other areas of the law beginning in the 1930's, the United States Supreme Court, which previously had refused to allow retroactive gift taxation, did an "about face" and, in an opinion which stretches the bounds of credulity, approved the practice.

Of course, there were probably not that many voters in 1935 who derived virtually all of their income from stock dividends. It was a particularly easy political route for the Wisconsin legislature to follow. Sure, the taxpayers affected were miffed, but my bet is they were a small minority of the voter base. Passage of Senate Bill 94 will take away the temptation and the opportunity to play political games with taxation of this type. And, if we analyze honestly the times in the past when retroactive taxation has occurred, we must admit that those games have been played.

In conclusion, passage of Senate Bill 94 is a vital part of the process of reforming taxation in the United States so as to make it simple, fair and equitable. The vast majority of Americans desperately want their Federal taxation system to be changed so that they can be freed from the incessant tax rituals they now undergo. They want a tax system that is simple, predictable, fair, intelligible and stable. They want something very different from what we have today.

Thank you.

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